

*Defense Finance and Accounting
Service
Working Capital Fund*

Chief Financial
Officer
Annual Financial
Statement
FY 1997

February 27, 1998

Defense Finance and Accounting Service

Working Capital Fund

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***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

CONSOLIDATED OPERATIONS

OVERVIEW

**DEFENSE FINANCE AND ACCOUNTING SERVICE
CONSOLIDATED OPERATIONS
DEFENSE WORKING CAPITAL FUND
OVERVIEW OF THE REPORTING ENTITY**

These financial statements report on the financial position and results of operations of the Defense Finance and Accounting Service (DFAS) Financial Operations and Information Services business areas of the Defense Working Capital Fund (DWCF) for FY 1997. They are prepared pursuant to the requirements of the Chief Financial Officer's Act of 1990 (CFO) and Department of Defense (DoD) implementing guidance.

The financial statements include all aspects of DFAS commercial operations. They do not include any other appropriated, trust, or revolving funds. The principal statements are prepared from the same sources as are reports used to monitor and control budgetary resources.

Description of the Reporting Entity

DFAS operations consist of two business areas, Financial Operations and Information Services. These two business areas contribute to DFAS ability to provide effective and efficient finance and accounting services during times of peace and conflict.

When DFAS was established in FY 1991, DoD took a giant step forward in streamlining financial systems. DFAS became the pivotal agent for key financial management reforms. During FY 1992, DFAS Financial Operations capitalized over 16,000 additional finance and accounting personnel at more than 300 locations in the continental United States. A major streamlining milestone was the announcement in May 1994, by the Deputy Secretary of Defense, of the consolidation of finance and accounting operations. Since that announcement, 307 of 332 DoD field activities have been closed and their processes consolidated at seventeen DFAS Operating Locations and five DFAS Centers. When consolidation is complete, by November 1998, DoD finance and accounting operations will be conducted at no more than 26 DFAS sites with an annual saving of \$120 million.

The DFAS workforce consists of military members from the Army, Air Force, Navy, Marine Corps, and civilians. The size of the military and civilian workforce employed for DFAS as of September 30, 1997:

| | |
|----------|--------|
| Military | 1,659 |
| Civilian | 21,662 |

Overview

DFAS has taken aggressive measures to respond favorably to the DoD manpower requirement to downsize both the military and civilian end strength levels. For the past four years, DFAS has exceeded the OSD mandatory civilian and military reduction goals. Since its inception in January 1991 through September 30, 1997, DFAS has capitalized over 31,000 positions. However by consolidating operations, standardizing systems, and reengineering business processes, DFAS has been able to eliminate over 8,000 positions. DFAS civilian and military end strength are scheduled to decline by 39 percent from the FY 1994 baseline of 26,453 to 16,169 in FY 2003.

The DFAS Financial Services Organization (FSO) functions as a fee-for-service operation under the DWCF Information Services business area. The FSO provides software development/modernization and systems maintenance support to over 100 Automated Information Services (AIS), as well as providing overall technical support in a number of system-related areas. The primary areas of emphasis are the acquisition, deployment, and support for the DFAS information technology (I/T) infrastructure.

The FSO operates as a single organization with a small headquarters contingent located in Indianapolis and subordinate Financial Systems Activities (FSAs) in Cleveland, Columbus, Pensacola, Indianapolis, Kansas City, and Denver. During FY 1996, the FSO delivered over 2.5 million direct labor hours in accomplishing its software development and maintenance mission.

The DFAS Consolidated Principal Statements consist of both the Financial Operations and the Information Services Operations results. The consolidated statements have been adjusted to reflect the elimination of intra-departmental transactions between the two entities.

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE

WORKING CAPITAL
FUND

CONSOLIDATED
PRINCIPAL STATEMENTS***

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund - Consolidated
Statement of Financial Position
As of September 30, 1997
(Thousands)

| ASSETS | <u>1997</u> | <u>1996</u> |
|--|-------------------------|-------------------------|
| 1. Entity Assets: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balance with Treasury (Note 2) | \$53,395 | (\$92,316) |
| (2) Investments, Net (Note 4) | 0 | 0 |
| (3) Accounts Receivable, Net (Note 5) | 29,775 | 55,060 |
| (4) Interest Receivable | 0 | 0 |
| (5) Advances and Prepayments | 0 | 0 |
| (6) Other Federal (Intragovernmental) (Note 6) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Investments (Note 4) | 0 | 0 |
| (2) Accounts Receivable, Net (Note 5) | 126 | 37 |
| (3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7) | 0 | 0 |
| (4) Interest Receivable, Net | 0 | 0 |
| (5) Advances and Prepayments | 690 | 1,036 |
| (6) Other Non-Federal (Governmental) (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Inventory, Net (Note 8) | 0 | 0 |
| e. Work in Process (Note 9) | 0 | 0 |
| f. Operating Materials/Supplies, Net (Note 10) | 0 | 0 |
| g. Stockpile Materials, Net (Note 11) | 0 | 0 |
| h. Seized Property (Note 12) | 0 | 0 |
| i. Forfeited Property, Net (Note 13) | 0 | 0 |
| j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14) | 0 | 0 |
| k. Property, Plant and Equipment, Net (Note 15) | 593,106 | 517,025 |
| l. War Reserves | 0 | 0 |
| m. Other Entity Assets | 57,720 | 8,456 |
| n. Total Entity Assets | <u>\$734,812</u> | <u>\$489,298</u> |
| 2. Non-Entity Assets: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balance with Treasury (Note 2) | \$0 | \$0 |
| (2) Accounts Receivable, Net (Note 5) | 0 | 0 |
| (3) Interest Receivable, Net | 0 | 0 |
| (4) Other (Note 6) | 0 | 0 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund - Consolidated
Statement of Financial Position
As of September 30, 1997
(Thousands)

| ASSETS, Continued | <u>1997</u> | <u>1996</u> |
|---|-----------------------------|-----------------------------|
| 2. Non-Entity Assets: | | |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Receivable, Net (Note 5) | \$0 | \$0 |
| (2) Interest Receivable, Net | 0 | 0 |
| (3) Other (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Other Non-Entity Assets | 0 | 0 |
| e. Total Non-Entity Assets | <u>\$0</u> | <u>\$0</u> |
| 3. Total Assets | <u><u>\$734,812</u></u> | <u><u>\$489,298</u></u> |
| LIABILITIES | | |
| 4. Liabilities Covered by Budgetary Resources: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | \$163,733 | 175,178 |
| (2) Interest Payable | 0 | 0 |
| (3) Debt (Note 16) | 0 | 0 |
| (4) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 286,253 | 288,590 |
| (2) Accrued Payroll and Benefits | | |
| (a) Salaries and Wages | 8,223 | 3,680 |
| (b) Annual Accrued Leave | 384 | 384 |
| (c) Severance Pay and Separation Allowance | 0 | 0 |
| (3) Interest Payable | 0 | 250 |
| (4) Liabilities for Loan Guarantees (Note 7) | 0 | 0 |
| (5) Lease Liabilities (Note 18) | 0 | 0 |
| (6) Pensions and Other Actuarial Liabilities (Note 19) | 0 | 0 |
| (7) Other Non-Federal (Governmental) Liabilities (Note 17) | 0 | 0 |
| c. Total Liabilities Covered by Budgetary Resources: | <u><u>\$458,593</u></u> | <u><u>\$468,082</u></u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund - Consolidated
Statement of Financial Position
As of September 30, 1997
(Thousands)

| LIABILITIES, Continued | <u>1997</u> | <u>1996</u> |
|--|------------------------------------|------------------------------------|
| 5. Liabilities Not Covered by Budgetary Resources: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | \$0 | \$0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 0 | 0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Lease Liabilities (Note 18) | 0 | 0 |
| (4) Pensions and Other Actuarial Liabilities (Note 19) | 82,985 | 0 |
| (5) Other Non-Federal (Governmental) Liabilities (Note 17) | 54,927 | 55,757 |
| c. Total Liabilities Not Covered by Budgetary Resources | <u>\$137,912</u> | <u>\$55,757</u> |
| 6. Total Liabilities | \$596,505 | \$523,839 |
| NET POSITION (Note 20) | | |
| 7. Balances: | | |
| a. Unexpended Appropriations | \$0 | \$0 |
| b. Invested Capital | 95,136 | (35,077) |
| c. Cumulative Results of Operations | 181,083 | 56,293 |
| d. Other | 0 | 0 |
| e. Future Funding Requirements | (137,912) | (55,757) |
| f. Total Net Position | <u>\$138,307</u> | <u>(\$34,541)</u> |
| 8. Total Liabilities and Net Position | <u><u>\$734,812</u></u> | <u><u>\$489,298</u></u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund - Consolidated

Statement of Operations and Changes in Net Position

For the Period Ended September 30, 1997

(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|--------------------|--------------------|
| REVENUES AND FINANCING SOURCES | | |
| 1. Appropriated Capital Used | \$0 | \$0 |
| 2. Revenues from Sales of Goods and Services | | |
| a. To the Public | 329 | 0 |
| b. Intragovernmental | 1,782,830 | 1,631,285 |
| 3. Interest and Penalties, Non-Federal | 0 | 0 |
| 4. Interest, Federal | 0 | 0 |
| 5. Taxes (Note 21) | 0 | 0 |
| 6. Other Revenues and Financing Sources (Note 22) | 74,897 | 33,961 |
| 7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies | 0 | 0 |
| 8. Total Revenues and Financing Sources | <u>\$1,858,056</u> | <u>\$1,665,246</u> |
| EXPENSES | | |
| 9. Program or Operating Expenses (Note 23) | \$0 | \$0 |
| 10. Cost of Goods Sold (Note 24) | | |
| a. To the Public | 0 | 0 |
| b. Intragovernmental | 1,511,021 | 1,534,924 |
| 11. Depreciation and Amortization | 144,632 | 120,673 |
| 12. Bad Debts and Writeoffs | 0 | 0 |
| 13. Interest | | |
| a. Federal Financing Bank/Treasury Borrowing | 0 | 0 |
| b. Federal Securities | 0 | 0 |
| c. Other | 0 | 0 |
| 14. Other Expenses (Note 25) | 74,897 | 384 |
| 15. Total Expenses | <u>\$1,730,550</u> | <u>\$1,655,981</u> |
| 16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items | \$127,506 | \$9,265 |
| 17. Plus (Minus) Extraordinary Items (Note 26) | 0 | 0 |
| 18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | <u>\$127,506</u> | <u>\$9,265</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund - Consolidated

Statement of Operations and Changes in Net Position

For the Period Ended September 30, 1997

(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|------------------|-------------------|
| EXPENSES, Continued | | |
| 19. Net Position, Beginning Balance, as Previously Stated | (\$34,541) | \$298,507 |
| 20. Adjustments (Note 27) | 0 | 33 |
| 21. Net Position, Beginning Balance, as Restated | (\$34,541) | \$298,540 |
| 22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | 127,506 | 9,265 |
| 23. Plus (Minus) Non Operating Changes (Note 28) | 45,342 | (342,346) |
| 24. Net Position, Ending Balance | <u>\$138,307</u> | <u>(\$34,541)</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund - Consolidated
 Statement of Cash Flows
 For the Period Ended September 30, 1997
 (Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|--------------------|--------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| 1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | <u>\$127,506</u> | <u>\$9,265</u> |
| Adjustments Affecting Cash Flow: | | |
| 2. Appropriated Capital Used | 0 | 0 |
| 3. Decrease (Increase) in Accounts Receivable | 28,679 | (38,442) |
| 4. Decrease (Increase) in Other Assets | 345 | (207) |
| 5. Increase (Decrease) in Accounts Payable | (17,567) | 57,574 |
| 6. Increase (Decrease) in Other Liabilities | 4,930 | (6,105) |
| 7. Depreciation and Amortization | 144,632 | 120,672 |
| 8. Other Unfunded Expenses | 420 | 0 |
| 9. Other Adjustments | (3,291) | 250 |
| 10. Total Adjustments | <u>\$158,148</u> | <u>\$133,742</u> |
| 11. Net Cash Provided (Used) by Operating Activities | <u>\$285,654</u> | <u>\$143,007</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| 12. Sale of Property, Plant and Equipment | \$0 | \$0 |
| 13. Purchase of Property, Plant and Equipment | (232,259) | (235,323) |
| 14. Sale of Securities | 0 | 0 |
| 15. Purchase of Securities | 0 | 0 |
| 16. Collection of Loans Receivable | 0 | 0 |
| 17. Creation of Loans Receivable | 0 | 0 |
| 18. Other Investing Cash Provided (Used) | <u>0</u> | <u>0</u> |
| 19. Net Cash Provided (Used) by Investing Activities | <u>(\$232,259)</u> | <u>(\$235,323)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| 20. Appropriations (Current Warrants) | \$0 | \$0 |
| 21. Add: | | |
| a. Restorations | 0 | 0 |
| b. Transfers of Cash from Others | 0 | 0 |
| 22. Deduct: | | |
| a. Withdrawals | 0 | 0 |
| b. Transfers of Cash to Others | (92,316) | 319,456 |
| 23. Net Appropriations | <u>\$92,316</u> | <u>(\$319,456)</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund - Consolidated

Statement of Cash Flows

For the Period Ended September 30, 1997

(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|------------------------|--------------------------|
| CASH FLOWS FROM FINANCING ACTIVITIES, Continued | | |
| 24. Borrowing from the Public | \$0 | \$0 |
| 25. Repayments on Loans to the Public | 0 | 0 |
| 26. Borrowing from the Treasury and the Federal Financing Bank | 0 | 0 |
| 27. Repayments on Loans from the Treasury and the Federal Financing Bank | 0 | 0 |
| 28. Other Borrowings and Repayments | <u>0</u> | <u>0</u> |
| 29. Net Cash Provided (Used) by Financing Activities | <u>\$92,316</u> | <u>(\$319,456)</u> |
| 30. Net Cash Provided (Used) by Operating, Investing and Financing Activities | \$145,711 | (\$411,772) |
| 31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning | <u>(92,316)</u> | <u>\$319,456</u> |
| 32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending | <u><u>\$53,395</u></u> | <u><u>(\$92,316)</u></u> |

Supplemental Disclosure of Cash Flow Information:

| | <u>1997</u> | <u>1996</u> |
|-------------------------|-------------|-------------|
| 33. Total Interest Paid | \$437 | \$1,955 |

Supplemental Schedule of Financing and Investing Activity:

| | <u>1997</u> | <u>1996</u> |
|--|-------------|-------------|
| 34. Property and Equipment Acquired Under Capital Lease Obligations | \$0 | \$0 |
| 35. Property Acquired Under Long-Term Financing Arrangements | \$0 | \$0 |
| 36. Other Exchanges of Non-cash Assets or Liabilities | \$0 | \$0 |

The accompanying notes are an integral part of these statements.

Principal Statements

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund - Consolidating
Statement of Financial Position
As of September 30, 1997
(Thousands)

| | | | | FY 1997 |
|--|--------------------------|-------------------|----------------------------|---------------------------|
| ASSETS | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>Grand Total</u> |
| 1. Entity Assets: | | | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | | | |
| (1) Fund Balance with Treasury (Note 2) | \$65,227 | (\$11,832) | \$0 | \$53,395 |
| (2) Investments, Net (Note 4) | 0 | 0 | 0 | 0 |
| (3) Accounts Receivable, Net (Note 5) | 27,428 | 33,764 | (31,417) | 29,775 |
| (4) Interest Receivable | 0 | 0 | 0 | 0 |
| (5) Advances and Prepayments | 0 | 0 | 0 | 0 |
| (6) Other Federal (Intragovernmental) (Note 6) | 0 | 0 | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | | | |
| (1) Investments (Note 4) | 0 | 0 | 0 | 0 |
| (2) Accounts Receivable, Net (Note 5) | 118 | 8 | 0 | 126 |
| (3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7) | 0 | 0 | 0 | 0 |
| (4) Interest Receivable, Net | 0 | 0 | 0 | 0 |
| (5) Advances and Prepayments | 692 | (2) | 0 | 690 |
| (6) Other Non-Federal (Governmental) (Note 6) | 0 | 0 | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 | 0 | 0 |
| d. Inventory, Net (Note 8) | 0 | 0 | 0 | 0 |
| e. Work in Process (Note 9) | 0 | 0 | 0 | 0 |
| f. Operating Materials/Supplies, Net (Note 10) | 0 | 0 | 0 | 0 |
| g. Stockpile Materials, Net (Note 11) | 0 | 0 | 0 | 0 |
| h. Seized Property (Note 12) | 0 | 0 | 0 | 0 |
| i. Forfeited Property, Net (Note 13) | 0 | 0 | 0 | 0 |
| j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14) | 0 | 0 | 0 | 0 |
| k. Property, Plant and Equipment, Net (Note 15) | 571,371 | 21,735 | 0 | 593,106 |
| l. War Reserves | 0 | 0 | 0 | 0 |
| m. Other Entity Assets | 37,539 | 20,181 | 0 | 57,720 |
| n. Total Entity Assets | \$702,375 | \$63,854 | (\$31,417) | \$734,812 |
| 2. Non-Entity Assets: | | | | |
| a. Transactions With Federal (Intragovernmental) Entities: | | | | |
| (1) Fund Balance with Treasury (Note 2) | \$0 | \$0 | \$0 | \$0 |
| (2) Accounts Receivable, Net (Note 5) | 0 | 0 | 0 | 0 |
| (3) Interest Receivable, Net | 0 | 0 | 0 | 0 |
| (4) Other (Note 6) | 0 | 0 | 0 | 0 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund - Consolidating
 Statement of Financial Position
 As of September 30, 1997
 (Thousands)

| | | | | FY 1997 |
|---|-------------------|-----------------|---------------------|--------------------|
| ASSETS, Continued | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>Grand Total</u> |
| 2. Non-Entity Assets: | | | | |
| b. Transactions with Non-Federal (Governmental) Entities: | | | | |
| (1) Accounts Receivable, Net (Note 5) | \$0 | \$0 | \$0 | \$0 |
| (2) Interest Receivable, Net | 0 | 0 | 0 | 0 |
| (3) Other (Note 6) | 0 | 0 | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 | 0 | 0 |
| d. Other Non-Entity Assets | 0 | 0 | 0 | 0 |
| e. Total Non-Entity Assets | \$0 | \$0 | \$0 | \$0 |
| 3. Total Assets | \$702,375 | \$63,854 | (\$31,417) | \$734,812 |
| LIABILITIES | | | | |
| 4. Liabilities Covered by Budgetary Resources: | | | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | | | |
| (1) Accounts Payable | \$185,276 | \$9,874 | (\$31,417) | \$163,733 |
| (2) Interest Payable | 0 | 0 | 0 | 0 |
| (3) Debt (Note 16) | 0 | 0 | 0 | 0 |
| (4) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | | | |
| (1) Accounts Payable | 257,860 | 28,393 | 0 | 286,253 |
| (2) Accrued Payroll and Benefits | | | | |
| (a) Salaries and Wages | 7,570 | 653 | 0 | 8,223 |
| (b) Annual Accrued Leave | 384 | 0 | 0 | 384 |
| (c) Severance Pay and Separation Allowance | 0 | 0 | 0 | 0 |
| (3) Interest Payable | 0 | 0 | 0 | 0 |
| (4) Liabilities for Loan Guarantees (Note 7) | 0 | 0 | 0 | 0 |
| (5) Lease Liabilities (Note 18) | 0 | 0 | 0 | 0 |
| (6) Pensions and Other Actuarial Liabilities (Note 19) | 0 | 0 | 0 | 0 |
| (7) Other Non-Federal (Governmental) Liabilities (Note 17) | 0 | 0 | 0 | 0 |
| c. Total Liabilities Covered by Budgetary Resources: | \$451,090 | \$38,920 | (\$31,417) | \$458,593 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund - Consolidating

Statement of Financial Position

As of September 30, 1997

(Thousands)

| | FY 1997 | | | |
|--|-------------------|-----------------|---------------------|--------------------|
| LIABILITIES, Continued | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>Grand Total</u> |
| 5. Liabilities Not Covered by Budgetary Resources: | | | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | | | |
| (1) Accounts Payable | \$0 | \$0 | \$0 | \$0 |
| (2) Debt (Note 16) | 0 | 0 | 0 | 0 |
| (3) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | | | |
| (1) Accounts Payable | 0 | 0 | 0 | 0 |
| (2) Debt (Note 16) | 0 | 0 | 0 | 0 |
| (3) Lease Liabilities (Note 18) | 0 | 0 | 0 | 0 |
| (4) Pensions and Other Actuarial Liabilities (Note 19) | 0 | 0 | 82,985 | 82,985 |
| (5) Other Non-Federal (Governmental) Liabilities (Note 17) | 48,843 | 6,084 | 0 | 54,927 |
| c. Total Liabilities Not Covered by Budgetary Resources | \$48,843 | \$6,084 | \$82,985 | \$137,912 |
| 6. Total Liabilities | \$499,933 | \$45,004 | \$51,568 | \$596,505 |
| NET POSITION (Note 20) | | | | |
| 7. Balances: | | | | |
| a. Unexpended Appropriations | \$0 | \$0 | \$0 | \$0 |
| b. Invested Capital | 66,228 | 28,908 | 0 | 95,136 |
| c. Cumulative Results of Operations | 185,057 | (3,974) | 0 | 181,083 |
| d. Other | 0 | 0 | 0 | 0 |
| e. Future Funding Requirements | (48,843) | (6,084) | (82,985) | (137,912) |
| f. Total Net Position | \$202,442 | \$18,850 | (\$82,985) | \$138,307 |
| 8. Total Liabilities and Net Position | \$702,375 | \$63,854 | (\$31,417) | \$734,812 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund - Consolidating
 Statement of Operations and Changes in Net Position
 For the Period Ended September 30, 1997
 (Thousands)

| | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>FY 1997</u> <u>Grand Total</u> |
|--|--------------------|------------------|---------------------|--------------------------------------|
| REVENUES AND FINANCING SOURCES | | | | |
| 1. Appropriated Capital Used | \$0 | \$0 | \$0 | \$0 |
| 2. Revenues from Sales of Goods and Services | | | | |
| a. To the Public | 329 | 0 | 0 | 329 |
| b. Intragovernmental | 1,769,620 | 204,138 | (190,928) | 1,782,830 |
| 3. Interest and Penalties, Non-Federal | 0 | 0 | 0 | 0 |
| 4. Interest, Federal | 0 | 0 | 0 | 0 |
| 5. Taxes (Note 21) | 0 | 0 | 0 | 0 |
| 6. Other Revenues and Financing Sources (Note 22) | 0 | 0 | 74,897 | 74,897 |
| 7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies | 0 | 0 | 0 | 0 |
| 8. Total Revenues and Financing Sources | \$1,769,949 | \$204,138 | (116,031) | \$1,858,056 |
| EXPENSES | | | | |
| 9. Program or Operating Expenses (Note 23) | \$0 | \$0 | \$0 | \$0 |
| 10. Cost of Goods Sold (Note 24) | | | | |
| a. To the Public | 0 | 0 | 0 | 0 |
| b. Intragovernmental | 1,507,944 | 194,005 | (190,928) | 1,511,021 |
| 11. Depreciation and Amortization | 137,466 | 7,166 | 0 | 144,632 |
| 12. Bad Debts and Writeoffs | 0 | 0 | 0 | 0 |
| 13. Interest | | | | |
| a. Federal Financing Bank/Treasury Borrowing | 0 | 0 | 0 | 0 |
| b. Federal Securities | 0 | 0 | 0 | 0 |
| c. Other | 0 | 0 | 0 | 0 |
| 14. Other Expenses (Note 25) | 0 | 0 | 74,897 | 74,897 |
| 15. Total Expenses | \$1,645,410 | \$201,171 | (116,031) | \$1,730,550 |
| 16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items | \$124,539 | \$2,967 | \$0 | \$127,506 |
| 17. Plus (Minus) Extraordinary Items (Note 26) | 0 | 0 | 0 | 0 |
| 18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | \$124,539 | \$2,967 | \$0 | \$127,506 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund - Consolidating

Statement of Operations and Changes in Net Position

For the Period Ended September 30, 1997

(Thousands)

| | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>FY 1997</u> <u>Grand Total</u> |
|--|-------------------|-----------------|---------------------|--------------------------------------|
| EXPENSES, Continued | | | | |
| 19. Net Position, Beginning Balance, as Previously Stated | (\$19,117) | (\$15,424) | \$0 | (\$34,541) |
| 20. Adjustments (Note 27) | 0 | 0 | 0 | 0 |
| 21. Net Position, Beginning Balance, as Restated | (\$19,117) | (\$15,424) | \$0 | (\$34,541) |
| 22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | 124,539 | 2,967 | 0 | 127,506 |
| 23. Plus (Minus) Non Operating Changes (Note 28) | 97,020 | 31,307 | (82,985) | 45,342 |
| 24. Net Position, Ending Balance | <u>\$202,442</u> | <u>\$18,850</u> | <u>(82,985)</u> | <u>\$138,307</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund - Consolidating
 Statement of Cash Flows
 For the Period Ended September 30, 1997
 (Thousands)

| | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>FY 1997</u> <u>Grand Total</u> |
|--|-------------------|------------|---------------------|--------------------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | |
| 1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | \$124,539 | \$2,967 | \$0 | \$127,506 |
| Adjustments Affecting Cash Flow: | | | | |
| 2. Appropriated Capital Used | 0 | 0 | 0 | 0 |
| 3. Decrease (Increase) in Accounts Receivable | 26,131 | 2,548 | 0 | 28,679 |
| 4. Decrease (Increase) in Other Assets | 343 | 2 | 0 | 345 |
| 5. Increase (Decrease) in Accounts Payable | (14,638) | (2,929) | 0 | (17,567) |
| 6. Increase (Decrease) in Other Liabilities | 4,597 | 333 | 0 | 4,930 |
| 7. Depreciation and Amortization | 137,466 | 7,166 | 0 | 144,632 |
| 8. Other Unfunded Expenses | 420 | 0 | 0 | 420 |
| 9. Other Adjustments | 2,472 | (5,763) | 0 | (3,291) |
| 10. Total Adjustments | \$156,791 | \$1,357 | \$0 | \$158,148 |
| 11. Net Cash Provided (Used) by Operating Activities | \$281,330 | \$4,324 | \$0 | \$285,654 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | |
| 12. Sale of Property, Plant and Equipment | \$0 | \$0 | \$0 | \$0 |
| 13. Purchase of Property, Plant and Equipment | (216,103) | (16,156) | 0 | (232,259) |
| 14. Sale of Securities | 0 | 0 | 0 | 0 |
| 15. Purchase of Securities | 0 | 0 | 0 | 0 |
| 16. Collection of Loans Receivable | 0 | 0 | 0 | 0 |
| 17. Creation of Loans Receivable | 0 | 0 | 0 | 0 |
| 18. Other Investing Cash Provided (Used) | 0 | 0 | 0 | 0 |
| 19. Net Cash Provided (Used) by Investing Activities | (\$216,103) | (\$16,156) | \$0 | (\$232,259) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | |
| 20. Appropriations (Current Warrants) | \$0 | \$0 | \$0 | \$0 |
| 21. Add: | | | | |
| a. Restorations | 0 | 0 | 0 | 0 |
| b. Transfers of Cash from Others | 0 | 0 | 0 | 0 |
| 22. Deduct: | | | | |
| a. Withdrawals | 0 | 0 | 0 | 0 |
| b. Transfers of Cash to Others | (57,647) | (34,669) | 0 | (92,316) |
| 23. Net Appropriations | \$57,647 | \$34,669 | \$0 | \$92,316 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund - Consolidating

Statement of Cash Flows

For the Period Ended September 30, 1997

(Thousands)

| | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>FY 1997 Grand Total</u> |
|--|-------------------|------------|---------------------|--------------------------------|
| CASH FLOWS FROM FINANCING ACTIVITIES, Continued | | | | |
| 24. Borrowing from the Public | \$0 | \$0 | \$0 | \$0 |
| 25. Repayments on Loans to the Public | 0 | 0 | 0 | 0 |
| 26. Borrowing from the Treasury and the Federal Financing Bank | 0 | 0 | 0 | 0 |
| 27. Repayments on Loans from the Treasury and the Federal Financing Bank | 0 | 0 | 0 | 0 |
| 28. Other Borrowings and Repayments | 0 | 0 | 0 | 0 |
| 29. Net Cash Provided (Used) by Financing Activities | \$57,647 | \$34,669 | \$0 | \$92,316 |
| 30. Net Cash Provided (Used) by Operating, Investing and Financing Activities | \$122,874 | \$22,837 | \$0 | \$145,711 |
| 31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning | (57,647) | (34,669) | 0 | (92,316) |
| 32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending | \$65,227 | (\$11,832) | \$0 | \$53,395 |

| | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>FY 1997 Grand Total</u> |
|--|-------------------|------------|---------------------|--------------------------------|
| Supplemental Disclosure of Cash Flow Information: | | | | |
| 33. Total Interest Paid | \$437 | \$0 | \$0 | \$437 |

| | <u>Fin. Oper.</u> | <u>FSO</u> | <u>Eliminations</u> | <u>FY 1997 Grand Total</u> |
|--|-------------------|------------|---------------------|--------------------------------|
| Supplemental Schedule of Financing and Investing Activity: | | | | |
| 34. Property and Equipment Acquired Under Capital Lease Obligations | \$0 | \$0 | \$0 | \$0 |
| 35. Property Acquired Under Long-Term Financing Arrangements | \$0 | \$0 | \$0 | \$0 |
| 36. Other Exchanges of Non-cash Assets or Liabilities | \$0 | \$0 | \$0 | \$0 |

The accompanying notes are an integral part of these statements.

Principal Statements

The accompanying notes are an integral part of these statements.

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE

WORKING CAPITAL
FUND

CONSOLIDATED OPERATIONS

FOOTNOTES
TO THE
PRINCIPAL STATEMENTS***

Footnotes

**DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
DEFENSE WORKING CAPITAL FUND
CONSOLIDATED OPERATIONS
NOTES TO THE PRINCIPAL STATEMENTS
AS OF SEPTEMBER 30, 1997**

Note 1. Significant Accounting Policies

A. Basis of Presentation:

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the Department in accordance with DoD Guidance on Form and Content of Financial Statements For FY 1997 Financial Activity (as adopted from FMR, Volume 6, Chapter 6 issued January 1998, "Form and Content of Audited Financial Statements") and DoD's accounting policies which are summarized in this note. These statements, therefore, are different from the financial reports, also prepared by the DoD pursuant to OMB directive, that are used to monitor and control DoD's use of budgetary resources.

B. Reporting Entity:

The Department of Defense (DoD) was created on September 18, 1947 by the National Security Act of 1947. The overall mission of the Department is to organize, train, and equip forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies.

On November 26, 1990, DoD Directive 5118.5, Defense Finance and Accounting Service established the Defense Finance and Accounting Service (DFAS) as an Agency of the Department of Defense (DoD) with responsibilities, functions, authorities, and relationships. The DFAS was established as an Agency of the DoD under the direction, authority and control of the Comptroller of the DoD. The primary responsibilities and functions included (1) DFAS shall direct finance and accounting requirements, systems, and functions for all appropriated, nonappropriated, working capital, revolving, and trust fund activities, including security assistance, (2) DFAS shall provide finance and accounting services for DoD Components and other Federal activities, as designated by the Comptroller, DoD, (3) DFAS shall execute statutory and regulatory financial reporting requirements and render financial statements, and (4) DFAS shall perform other functions as the Secretary of Defense, Deputy Secretary of Defense, or the Comptroller, DoD, may prescribe.

Footnotes

Fiscal Year 1997 represents the sixth full operational year for DFAS. Thus, these financial statements represent the sixth year that DFAS has prepared financial statements as required by the Chief Financial Officers (CFO) Act. The CFO Act requires that the Defense Finance and Accounting Service prepare and have audited three consolidated financial statements: (1) Statement of Financial Position, (2) Statement of Operations, and (3) Statement of Cash Flows. The audited financial statements are presented on the accrual basis of accounting as required by General Accounting Office's Title 2, of the Policy and Procedures Manual for Guidance of Federal Agencies.

The Defense Business Management System (DBMS), an automated management information system, is used by the Agency to develop the financial and other managerial information. DBMS was designated as the migratory system for the Defense Working Capital Fund.

C. Budgets and Budgetary Accounting:

The Department expanded the use of professional financial management practices through the establishment of the Defense Working Capital Fund (formerly Defense Business Operations Fund) on October 1, 1991. The Fund operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision-making process. The Fund builds on the revolving fund principles previously used for industrial and commercial-type activities.

The Agency's major budget activity is the financial operations business area operating under the Working Capital Fund (Account Symbol 97X4930.5L), a revolving fund.

The DFAS Financial Services Organization's (FSO) major budget activity is the financial operations business area operating under the Working Capital Fund (Account Symbol 97X4930.5F40), a revolving fund.

D. Basis of Accounting:

Transactions are recorded on an accrual accounting basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Also, when costs are incurred on a relatively uniform basis over the life of an order, revenue may be recognized as a percentage of incurred costs to total projected costs. At a minimum, the customer shall be billed and revenue recognized at the end of each fiscal year quarter. In summary the Fund shall operate under financial policies and responsibilities currently in effect for stock and industrial funds, except as modified by DoD Comptroller policy documents.

E. Revenues and Other Financing Sources:

Revenue is earned and recognized when services are completed and billed or on a percentage of completion method.

For financial reporting purposes under accrual accounting, operating expenses are recognized in the period incurred. Expenditures for capital and other long-term assets are receipted then capitalized when purchased, but are not depreciated until they are put into operation by the Department.

Prior to FY97, due to inadequate system support, the annual leave liability was treated as an unfunded liability and future funding requirements on the Statement of Financial Position. In FY97, it was determined that any increase to the annual leave account (GLAC 2300.000) between the FY96 and FY97 ending balances would be recorded on the Statement of Operations and Changes in Net Position as an expense and as a funded liability on the Statement of Financial Position. If the change in the FY97 and FY96 ending balances results in a decrease, the unfunded liability and future funding requirement on the Statement of Financial Position would be adjusted accordingly.

F. Accounting for Intra-governmental Activities:

DFAS, as the Department's accountant, and the FSO, as DFAS' systems development provider, interacts with the other DoD Components in a typical business manner, i.e. provides accounting service to the Program Managers and DoD Comptroller. Our service includes the accounting and finance service for approximately 300 fund accounts. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department or the Working Capital Fund. These statements reflect the Financial Operations and Financial Systems Organization business portion of the Working Capital Fund.

Like the other DoD Components, the DFAS employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while assigned military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security.

G. Funds with the U.S. Treasury and Cash:

The Agency's fund resources as part of the Working Capital Fund are maintained in the Treasury account. The Fund's cash receipts and disbursements are processed by the Treasury, and the balance with the Treasury represents the aggregate of all unexpended balances at the summary level.

H. Foreign Currency:

Not Applicable.

Footnotes

I. Accounts Receivable:

As presented in the Statement of Financial Position, accounts receivable includes accounts, claims and refunds receivable, advance payments to other entities and eliminating entries (See Note 29). Allowances for uncollectible accounts were established in FY 1994. Allowances for Bad Debts were determined in accordance with DoD 7220.9M and DFAS guidance. The total amount was recorded in the Allowance for Bad Debts account pending final write-off approval.

J. Loans Receivable:

Not Applicable.

K. Inventories:

Not Applicable.

L. Investments in U.S. Government Securities:

Not Applicable.

M. Property and Equipment:

All Defense Finance and Accounting Service property, plant and equipment is recorded in the Defense Property Accountability System (DPAS). The capital assets include, but are not limited to, physical plant and property, (including government owned facilities, property acquired under a capital lease or an operating lease), equipment and software. The assets were purchased with capital funds. For assets purchased with Fiscal Year 1992 and 1993 capital funds, the original purchase price (including installation and transportation costs) exceeded \$15,000. For assets purchased with Fiscal Year 1994 capital funds, the original purchase price exceeded \$25,000. For assets purchased with Fiscal Year 1995 and Fiscal Year 1996 capital funds, the original purchase price exceeded \$50,000.

DPAS was balanced and reconciled to the certified trial balances for fiscal year 1997. The largest component of property, plant, and equipment is ADP software with a Net Book Value of \$296,830. The Net Book Value for Fixed Assets (In-Use) is \$593,106.

Routine maintenance and repair costs are expensed when incurred. Depreciation of property and equipment is calculated on a straight line basis. Defense Finance and Accounting Service (DFAS) expensed \$144,632 in depreciation for this fiscal year and expensed \$440,742 in depreciation from inception of the Defense Working Capital Fund. The accumulated depreciation which includes depreciation on assets transferred-in, from inception is \$513,398 (See Note 15 for the Book Value of DFAS's depreciated assets).

The General Accounting Office (GAO) has determined that real property used by the DWCF, but under the jurisdiction of the Military Departments, represents an asset of the DWCF

and such property should be reported on the financial statements as an entity asset to show the full costs of all resources and assets used in DWCF operations.

N. Prepaid and Deferred Charges:

Not Applicable.

O. Leases:

Not Applicable.

P. Contingencies:

Not Applicable.

Q. Accrued Leave:

Civilian employee annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for the civilian annual leave and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of nonvested leave are expensed as taken. Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current of prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. DFAS has \$54,928 in Accrued Annual Leave that is reported as a liability not covered by current budgetary resources.

R. Equity:

Equity consists of invested capital, cumulative result of operations, and future funding requirements. Invested capital, as presented in the Statement of Financial Position, represents the net value of the capital asset transferred to or from the DFAS-Financial Operations and Financial Systems organization from or to other organizations.

Cumulative results of operations represents the excess of revenues over total expenses since the inception of the reporting entity, less refunds to customers and returns to the U. S. Treasury.

S. Aircraft/Ship Crashes:

Not Applicable.

T. Treaties for Use of Foreign Bases:

Not Applicable.

Footnotes

U. Comparative Data [for use by reporting entities preparing CFO financial statements for the first time]:

Not Applicable.

W. Undelivered Orders:

All DoD Components are obligated for goods and services which have been ordered but not yet received (undelivered orders) as of September 30, 1997. Aggregate undelivered orders amounted to \$54,517 as of September 30, 1997.

Note 2. Fund Balances with Treasury

A. Working Capital Fund (USD(C)) and All Other Funds and Accounts:

Not Applicable.

B. Working Capital Fund Activities Below (USD(C)) Level:

| | Entity Assets | |
|-------------------------------|------------------------|------------------------|
| | <u>Funds Collected</u> | <u>Funds Disbursed</u> |
| Beginning Balance | 1,761,618 | (1,887,895) |
| Transfers of Cash to Others | (1,761,618) | |
| Transfers of Cash from Others | | 1,887,895 |
| Funds Collected | 2,008,231 | |
| Funds Disbursed | | (1,954,836) |
| Ending Balance | <u>2,008,231</u> | <u>(1,954,836)</u> |

C. All Funds and Accounts:

Not Applicable.

D. Other Information:

Cash collections and disbursements data for the financial statements is obtained from the finance network/Cash Outlay System Report and Service listings. The difference between cash collections in the finance network/Cash Outlay System Report and the general ledger amounted to \$3,451. This amount is reported as an increase in accounts receivable. The difference between cash disbursements in the finance network/Cash Outlay System Report and the general ledger amounted to \$70,387. This amount is reported as an increase in accounts payable.

For Financial Operations, the current year undistributed amount for reimbursements was incorrectly reported as an increase to the trial balance amount. This amount should have been a decrease to the trial balance. The total collections should be \$1,795,035.

The disbursement amount should have read \$1,733,699. The difference between what was reported on the financial statements for disbursements and what should have been reported, was due to using the Cash Listing vs. the Cash Outlay System. The Cash Outlay was unavailable at the time of producing these reports.

With the above changes, the total Fund Balance with Treasury amount should be \$73,170. Due to the timing in discovering these discrepancies, the adjustments were not made to the FY97 statements, but will be made on the FY98 statements.

Note 3. Cash, Foreign Currency and Other Monetary Assets

Not Applicable.

Note 4. Investments

Not Applicable.

Note 5. Accounts Receivable, Net

| | (1) Allowance Amount <u>Due</u> | (2) Allowance For Estimated <u>Uncollectibles</u> | (3) Method <u>Used</u> | (4) Amount <u>Due</u> |
|-----------------------------------|--|--|------------------------------|-----------------------------|
| A. Entity Receivables: | | | | |
| Intragovernmental | 29,662 | (113) | | 29,775 |
| Governmental | 126 | | | 126 |
| Total | 29,788 | (113) | | 29,901 |
| B. Non-Entity Receivables: | | | | |
| Intragovernmental | | | | |
| Governmental | | | | |

C. Other Information: The consolidated line on the financial statements also includes Intrafund Elimination entries of \$31,417 (see Note 29).

The Accounts Receivable Intragovernmental was increased by \$17,638 due to undistributed collections. Undistributed dollars are the difference between cash collections in the finance network/Cash Outlay System Report and the general ledger. The allowance for Accounts Receivables is for Refunds Receivable.

Footnotes

Accounts Receivable may also include numerous over-aged and negative transactions. These transactions are currently under investigation for system and processing deficiencies. See Note 31 for detail on the amounts of these transactions at year-end.

Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets

Not Applicable.

Note 7. Loans and Loan Guarantees, Non-Federal Borrowers

Not Applicable.

Note 8. Inventory, Net

Not Applicable.

Note 9. Work in Process

Not Applicable.

Note 10. Operating Materials and Supplies (OM&S), Net

Not Applicable.

Note 11. Stockpile Materials Net

Not Applicable.

Note 12. Seized Property

Not Applicable.

Note 13. Forfeited Property, Net

Not Applicable.

Note 14. Goods Held Under Price Support and Stabilization Programs, Net

Not Applicable.

Note 15. Property, Plant, and Equipment, Net

| | (1) Depreci- ation <u>Method</u> | (2) Service Life | (3) Acquisition Value | (4) Accumulated Depreciation | (5) Net Book Value |
|--|---|------------------------|-----------------------------|------------------------------------|-----------------------------|
| <u>Classes of Fixed Assets</u> | | | | | |
| A. Land | | | | | |
| B. Structures, Facilities, & Leasehold Improvements | S/L | 11-20 | 7,166 | 4,028 | 3,138 |
| C. Military Equipment | S/L | 1-5 | 3,489 | | 3,489 |
| D. ADP Software | S/L | 1-5 | 694,510 | 397,679 | 296,831 |
| E. Equipment | S/L | 1-5 | 145,987 | 88,983 | 57,004 |
| F. Assets Under Capital Lease | S/L | 1-5 | | | |
| G. Other | S/L | 1-5 | 26,046 | 22,708 | 3,338 |
| H. Natural Resources | | | | | |
| I. Construction-in-Progress | | | 229,306 | | 229,306 |
| Total | | | 1,106,504 | 513,398 | 593,106 |

*Keys:

| <u>Depreciation Methods</u> | <u>Range of Service Life</u> | |
|--|------------------------------|----------------|
| SL - Straight Line | 1-5 | 1 to 5 years |
| DD - Double-Declining Balance | 6-10 | 6 to 10 years |
| SY - Sum of the Years' Digits | 11-20 | 11 to 20 years |
| IN - Interest (sinking fund) | >20 | Over 20 years |
| PR - Production (activity or use method) | | |
| OT - Other (describe) | | |

J. Other Information:

For Financial Operations (5L), ADP Software, Net is incorrectly understated by \$2,852. The correction for this error will be made on the FY98 financial statements.

Note 16. Debt

Not Applicable.

Note 17. Other Liabilities

A. Other Liabilities Covered by Budgetary Resources:

Not Applicable.

Footnotes

B. Other Information:

Not Applicable.

C. Other Liabilities Not Covered by Budgetary Resources:

| | Non-Current <u>Liability</u> | Current <u>Liability</u> | <u>Total</u> |
|--------------------------|---------------------------------|-----------------------------|---------------|
| 1. Intragovernmental | | | |
| (1) Accrued Annual Leave | 54,927 | | 54,927 |
| Total | <u>54,927</u> | | <u>54,927</u> |

Note 18. Leases

Not Applicable.

Note 19. Pensions and Other Actuarial Liabilities

| Major Program Activities | Actuarial Present Value of Projected Plan Benefits | Assumed Interest Rate (%) | Assets Available to Pay Benefits | Unfunded Actuarial Liability |
|-----------------------------|--|---------------------------------|---|------------------------------------|
| A. Pension and Health Plans | | | | |
| B. Insurance/Annuity | | | | |
| C. Other | | | | |
| Workers Compensation | | | | 82,985 |
| Total | | | | <u>82,985</u> |

Future workers' compensation figures are provided by the Department of Labor. The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's, June 10, 1997 economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

1997
6.27% in year 1
5.82% in year 2
5.60% in year 3
5.45% in year 4
5.40% in year 5 and thereafter

Note 20. Net Position

| | <u>Revolving Funds</u> | <u>Trust Funds</u> | <u>Appropriated Funds</u> | <u>Total</u> |
|--|----------------------------|------------------------|-------------------------------|----------------|
| A. Unexpended Appropriations: | | | | |
| (1) Unobligated, | | | | |
| a. Available | | | | |
| b. Unavailable | | | | |
| (2) Undelivered Orders | | | | |
| B. Invested Capital | 95,136 | | | 95,136 |
| C. Cumulative Results of Operations | 181,083 | | | 181,083 |
| D. Other | | | | |
| E. Future Funding Requirements | (137,912) | | | (137,912) |
| F. Total | <u>138,307</u> | <u> </u> | <u> </u> | <u>138,307</u> |

Note 21. Taxes

Not Applicable.

Note 22. Other Revenues and Financing Sources

| | |
|---|-----------------|
| Imputed Pension and Other Retirement Benefits (ORB) | |
| CSRS/FERS Retirement | \$52,635 |
| Health | 22,195 |
| Life Insurance | <u>67</u> |
| | <u>\$74,897</u> |

The \$74,897 represents the imputed financing for pensions and other retirement benefits. The Office of Personnel management (OPM) is the administrative entity for pensions and other retirement benefits (ORB). OPM accounts for and reports the pension liability in the financial statements while the employer discloses the imputed financing. OPM actuaries provide the normal cost rates which are used to calculate the imputed financing.

Note 23. Program or Operating Expenses

Not Applicable.

Footnotes

Note 24. Cost of Goods Sold Do A, B, or C as appropriate.

A. Cost of Services Sold:

| | |
|--|-------------------------|
| (1) Beginning Work-in-Process | \$0 |
| (2) Plus: Operating Expenses | |
| (a) Personal Services and Benefits | 966,948 |
| (b) Travel and Transportation | 38,514 |
| (c) Rental, Communication and Utilities | 95,573 |
| (d) Printing and Reproduction | 19,128 |
| (e) Contractual Services | 525,744 |
| (f) Supplies and Materials | 19,279 |
| (g) Equipment not Capitalized | 34,265 |
| (h) Grants, Subsidies and Contributions | 1,631 |
| (i) Insurance Claims and Indemnities | |
| (j) Other (describe): | |
| (1) Interest Expense | 447 |
| (2) Real Property Maintenance | 396 |
| (3) Bad Debts | 24 |
| (4) Eliminating Entries* | (190,928) |
| (j) Total Expenses by Object Class | 1,511,021 |
| (3) Minus: Ending Work-in-Process | |
| (4) Minus: Completed Work for Activity Retention | |
| Cost of Services Sold | <u><u>1,511,021</u></u> |

Other Information:

*See Note 29 for Eliminating Entries.

Note 25. Other Expenses

| | <u>1996/7</u> | <u>1995/6</u> |
|--|----------------------|-------------------|
| A. Other Expenses: | | |
| (1) Accrued Annual Leave | | 384 |
| (2) Pensions/Other Retirement Benefits | 74,897 | |
| Total | <u><u>74,897</u></u> | <u><u>384</u></u> |

B. Other Information:

| | |
|---|------------------------|
| Imputed Pension and Other Retirement Benefits (ORB) | |
| CSRS/FERS Retirement | \$52,635 |
| Health | 22,195 |
| Life Insurance | <u>67</u> |
| | <u><u>\$74,897</u></u> |

The \$74,897 represents the imputed expense for pensions and other retirement benefits. The Office of Personnel management (OPM) is the administrative entity for pension sand other retirement benefits (ORB). OPM accounts for and reports the pension liability in the financial statements while the employer discloses the imputed expenses. OPM actuaries provide the normal cost rates which are used to calculate the imputed expenses.

Note 26. Extraordinary Items

Not Applicable.

Note 27. Prior Period Adjustments

Not Applicable.

Note 28. Non-Operating Changes - (Transfers and Donations)

| | <u>1996/7</u> | <u>1995/6</u> |
|--|----------------|--------------------|
| A. Increases: | | |
| (1) Transfers-In: | | |
| (a) Prior Year Cash Balance | (92,346) | (300,370) |
| (b) Capital Assets 9/30/97 | 135,761 | (84,912) |
| (2) Unexpended Appropriations | | |
| (3) Donations Received | | |
| (4) Other Increases | | |
| (5) Total Increases | <u>43,415</u> | <u>(385,282)</u> |
| | | |
| | <u>1996/7</u> | <u>1995/6</u> |
| B. Decreases: | | |
| (1) Transfers-Out: | | |
| (a) Capital Assets 9/30/96 | (84,912) | (42,936) |
| (2) Donations | | |
| (3) Other Decreases | | |
| Unfunded Liability-Workers Compensation | 82,985 | |
| (4) Total Decreases | <u>(1,927)</u> | <u>(42,936)</u> |
| C. Net Non-Operating Changes (Transfers): | <u>45,342</u> | <u>(\$342,346)</u> |

Footnotes

Note 29. Intrafund Eliminations

Schedule B: Eliminating Entries

| Selling Activity: | <u>Column A</u> <u>Accounts</u> <u>Receivable</u> | <u>Column B</u> <u>Revenue</u> | <u>Column C</u> <u>Unearned</u> <u>Revenue</u> | <u>Column D</u> <u>Collections</u> |
|--|---|-----------------------------------|--|---------------------------------------|
| Defense Finance and Accounting Service | 31,417 | 190,928 | 0.00 | 194,510 |
| TOTAL | 31,417 | 190,928 | 0.00 | 194,510 |

| Customer Activity: | <u>Column A</u> <u>Accounts</u> <u>Payable</u> | <u>Column B</u> <u>Expenses</u> | <u>Column C</u> <u>Advances</u> | <u>Column D</u> <u>Disbursements</u> |
|---|--|------------------------------------|------------------------------------|---|
| (SRC/CD) | | | | |
| 100.00 Intra DLA Support | 0.00 | 0.00 | 0.00 | 0.00 |
| 417.00 DFAS (Oth than 418) Btwn DFAS | 31,417 | 190,928 | 0.00 | 194,510 |
| 418.00 Intra-DLA (Def Stock Fd or Indus Fd) | 0.00 | 0.00 | 0.00 | 0.00 |
| TOTAL | 31,417 | 190,928 | 0.00 | 194,510 |

Schedule C: Eliminating Entries

| Selling Activity: | <u>Column A</u> <u>Accounts</u> <u>Receivable</u> | <u>Column B</u> <u>Revenue</u> | <u>Column C</u> <u>Unearned</u> <u>Revenue</u> | <u>Column D</u> <u>Collections</u> |
|--|---|-----------------------------------|--|---------------------------------------|
| Defense Finance and Accounting Service | 10,646 | 1,737,854 | 0.00 | 1,754,757 |
| TOTAL | 10,646 | 1,737,854 | 0.00 | 1,754,757 |

| Customer Activity: | <u>Column A</u> <u>Accounts</u> <u>Payable</u> | <u>Column B</u> <u>Expenses</u> | <u>Column C</u> <u>Advances</u> | <u>Column D</u> <u>Disbursements</u> |
|-------------------------------|--|------------------------------------|------------------------------------|---|
| (SRC/CD) | | | | |
| 411.00 Navy, Marine Corps | 4,146 | 531,116 | 0.00 | 540,227 |
| 412.00 Army | 3,870 | 675,757 | 0.00 | 687,272 |
| 416.00 Air Force | 1,768 | 357,011 | 0.00 | 363,158 |
| 414.00 DLA (Oth than 418) | 457 | 92,149 | 0.00 | 93,700 |
| 417.00 Other Defense Agencies | 405 | 81,821 | 0.00 | 83,230 |
| TOTAL | 10,646 | 1,737,854 | 0.00 | 1,754,757 |

Schedule D: Eliminating Entries

| Selling Activity: | <u>Column A</u> Accounts Receivable | <u>Column B</u> Revenue | <u>Column C</u> Unearned Revenue | <u>Column D</u> Collections |
|--|---|----------------------------|--|--------------------------------|
| Defense Finance and Accounting Service | 19,129 | 44,975 | 0.00 | 46,965 |
| TOTAL | 19,129 | 44,975 | 0.00 | 46,965 |

| Customer Activity: | <u>Column A</u> Accounts Payable | <u>Column B</u> Expenses | <u>Column C</u> Advances | <u>Column D</u> Disbursements |
|------------------------------------|--|-----------------------------|-----------------------------|----------------------------------|
| (SRC/CD) | | | | |
| 300.00 Off Budget Federal Entities | 0.00 | 0.00 | 0.00 | 0.00 |
| 600.00 Foreign Military Sales | 1,315 | 44,630 | 0.00 | 43,724 |
| 822.00 All Others | 141 | 345 | 0.00 | 273 |
| Other | 17,673 | N/A | N/A | 2,968 |
| TOTAL | 19,129 | 44,975 | 0.00 | 46,965 |

Earnings were given at a detail level, thus, allowing DFAS-CO to show Expenses at the lowest Customer Activity level as shown above. However, Accounts Receivable and Collections are not reflected in the Trial a Balance using the same detail level source code, therefore, detail Accounts Payable and Disbursements had to be computed using a percentage of Earnings in order to be shown at the same Customer Activity level.

Note 30. Contingencies:

Not Applicable.

Note 31. Other Disclosures:**A. Annual Leave**

Prior to FY97, due to inadequate system support, the annual leave liability was treated as an unfunded liability and future funding requirements on the Statement of Financial Position. In FY97, it was determined that any increase to the annual leave account (GLAC 2300.000) between the FY96 and FY97 ending balances would be recorded on the Statement of Operations and Changes in Net Position as an expense and as a funded liability on the Statement of Financial Position. If the change in the FY97 and FY96 ending balances results in a decrease, the unfunded liability and future funding requirement on the Statement of Financial Position would be adjusted accordingly.

Footnotes

B. Unmatched Disbursements (UMDs), Negative Unliquidated Obligations (NULOs), and Aged in-Transit Disbursements:

| Treasury Index 97 DFAS | September 1996 | September 1997 | Change | Percent Change |
|--------------------------------------|-------------------|-------------------|--------|----------------------|
| Unmatched Disbursements | 90,416 | 100,689 | 10,273 | 11.36% (Increase) |
| Negative Unliquidated Obligations | 3,723 | 3,367 | 356 | 9.56% (Decrease) |
| Totals | 94,139 | 104,056 | 9,917 | 10.53% (Increase) |

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

FINANCIAL OPERATIONS

OVERVIEW

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**DEFENSE FINANCE AND ACCOUNTING SERVICE
FINANCIAL OPERATIONS
DEFENSE WORKING CAPITAL FUND
OVERVIEW OF THE REPORTING ENTITY**

These financial statements report on the financial position and results of operations of the Defense Finance and Accounting Service (DFAS) financial operations business area of the Defense Working Capital Fund (DWCF) for FY 1997. They are prepared pursuant to the requirements of the Chief Financial Officer's Act of 1990 (CFO) and DoD implementing guidance.

The financial statements include all aspects of DFAS commercial operations. They do not include any other appropriated, trust, or revolving funds. The principal statements are prepared from the same sources as are reports used to monitor and control budgetary resources.

Description of the Reporting Entity

DFAS provides effective and efficient finance and accounting services during times of peace and conflict. Prior to January 1991, the DoD had a decentralized mode of operations. Reflecting that reality, the three military departments and major Defense Agencies have, until recent reforms began, always managed their own budget, finance, and accounting systems. As a result, they developed their own processes and business practices, geared to their particular mission, with little compatibility with other DoD operations. As Defense missions became more complicated, and DoD organizations were required to interact more with each other, systems compatibility and lack of standardization took a toll. Rather than redesigning its organization or standardizing its multitude of systems, the Department developed increasingly complex business practices to link its systems.

Such complexity left DoD financial systems prone to error or to demands that could not be achieved by the systems, personnel, or in the time available. No matter how knowledgeable and qualified the people operating the systems were, problems were inevitable. Moreover, there was an inherent inefficiency in having scores of incompatible systems performing virtually identical functions. In December 1991, DoD created DFAS to assume management responsibility for DoD components accounting operations and to consolidate the operations into a limited number of locations in order to realize significant savings. With the establishment of DFAS, DoD took a giant step forward in streamlining financial systems. DFAS became the pivotal agent for key financial management reforms.

Overview

By streamlining and standardizing DoD's finance and accounting policies, systems and operations, and eliminating redundancies, DFAS aims to improve finance and accounting operations and to reduce costs. DFAS was composed originally of six finance and accounting Centers located across the country with a small headquarters located in the Washington, D.C. area. DFAS was charged with providing finance and accounting services to the Army, Navy, Air Force, Marine Corps, Defense Logistics Agency (DLA), and the Washington Headquarters Service. Prior to the establishment of DFAS, each military department operated its own finance and accounting network, focused on its own requirements, using its own unique systems. Initially, the focus of the individual Centers did not change. Centers provided pay and financial management support to a single military department or agency. But as DFAS standardization and consolidation initiatives are implemented, Center missions are expanding and changing to support functions throughout DoD-wide.

DFAS has made great progress in its consolidation of DoD field finance and accounting activities since the announcement for consolidation was made in May 1994. All but 25 of the original 332 DoD activities have been closed and their work consolidated into 17 DFAS Operating Locations (reduced from the original 21 sites) and five DFAS Centers. The final round of consolidations will be completed by the end of FY 1998. This initiative and other savings helped DFAS achieve a reduction in its end strength of 8,000 spaces since FY 1992. With consolidation, savings are expected to total \$120 million per year.

Human Resources Initiatives

In 1996, the Human Resources Deputate initiated an HR Regionalization Program, which is progressing according to schedule. The Personnel Support Organization (PSO), headed by Deputy Director for Human Resources, was approved in September 1995 as the umbrella organization for all DFAS Human Resources services. Under the PSO are one Regional Service Center (RSC) located in Indianapolis, Indiana, and six Customer Support Units (CSUs) located at the five DFAS Centers and DFAS Headquarters. The RSC officially opened August 7, 1996. The RSC supports the CSUs by performing personnel services that do not require face-to-face contact with customers, such as personnel recordkeeping, system input, and vacancy announcements. The CSUs work directly with customers, advising and assisting DFAS managers and employees on personnel-related issues. Workload is moving from the CSUs to the RSC, which should result in efficiencies from economy of scale. Completion of the process is anticipated in June 1998. Critical to this is the anticipated roll-out of the modern technological suite, the backbone of which is Oracle HR.

To facilitate the development of the automated systems Human Resources will need to work smarter in the 21st Century. The Human Resources Information Systems and Solutions Directorate (HR-ISSD) was established in September 1997. The head of the directorate reporting directly to the Director of the Personnel Services Organization.

Additionally, as part of the Department of Defense regionalization and modernization initiatives, DFAS is partnering with the Defense Contract Audit Agency (DCAA) and the Defense

Information Systems Agency (DISA) to perform their regionalized services. Servicing for DCAA begins in August 1998; DISA servicing is scheduled for FY 1999.

With the commencement of consolidation in 1995, the Responsible Employer Program (REP) was created. The REP greatly reduced the number of involuntary separations throughout DFAS. It did this by giving employees options they would otherwise not have had. Before the REP, employees' only option was to register in the Department of Defense Priority Placement Program or elect separation incentives, if offered. By establishing the REP, employees had the opportunity to remain with DFAS if they were willing to relocate. As a result, 22 percent relocated.

In FY 1995, only 2 percent of those employees affected by the consolidation were separated. However, in 1996 and 1997, due to general government downsizing, there were fewer positions in the local commuting area available for people unwilling to relocate. Still, less than 5 percent have been involuntarily separated. Without REP, this number would have been higher.

With the facilities reductions and further Department of Defense downsizing called for by the Defense Reform Initiative, there will be even fewer positions in which to place impacted DFAS employees. However, Human Resources will strive to meet this challenge while continuing to be a Responsible Employer.

Project REFOCUS, a Headquarters Reinvention invention initiative, relieves managers of most of the administrative chores associated with such needs as staffing their offices and giving awards to their people. This gives them more time to effectively manage their programs. Deputates are serviced by designated specialists who provide advice and assistance in all areas of personnel management. Project REFOCUS provides one-stop personnel service to better serve customers. Managers can request HR assistance by e-mail and no longer need to fill out Standard Form 52s to request personnel actions.

With a smaller work force, relevant training and education become more important. DFAS is currently undertaking a Competency-Based Career Development program. Currently, seven out of eleven Career Development Plans have been developed, with the remaining plans scheduled for completion in early 1998. Plans for the Financial Management Career field were developed first and served as the prototype for the other career fields. The plans provide a road map for civilians to grow, advance or even change career fields and include professional and technical as well as leadership and management competencies. The plans set up a systematic process to develop DFAS employees from accession to separation through education, rotational assignments and self development initiatives. The plans will be accessible through an automated system that will allow DFAS supervisors to manage employees training and development through the use of Individual Development Plans.

Cornerstone is a two-week training program created to impart the DFAS vision as well as enhance leadership skills throughout the Agency. Through this program employees gain a basic foundation and understanding of the Senior Executive Service competencies. Specific topics covered in the course address leadership skills, strategic planning, decision making, problem

Overview

analysis, conflict resolution, team building, and creativity in the workplace. This course will be attended by all GS-14s and GS-15s in DFAS. High potential employees will be selected to move from Cornerstone to be part of the Certification program, which will provide additional training and developmental assignments.

DFAS is the executive agent for all defense agencies (all DoD components that are not part of a military service) for the Defense Leadership and Management Program (DLAMP). Implementing recommendations of the Commission on Roles and Missions of the Armed Forces, DLAMP is a systematic, Department-wide program of “joint” civilian leadership training, education, and development within and across DoD Components. It provides the framework for developing future civilian leaders with a DoD-wide capability. It also fosters an environment that nurtures a shared understanding and sense of mission among civilian employees and military personnel. Participation in the initial DLAMP class is limited to individuals in GS-14, GS-15 or equivalent positions. The initial class is scheduled to begin in early 1998. In future years, the program will be expanded to accept GS-12 and GS-13 participants.

Business Processing Reengineering

In past years, numerous nonstandard financial management policies have been promulgated within the Department. This environment often resulted in the application of different standards for similar circumstances, thereby producing inconsistent or incompatible information or reports. In response to this situation, the Department developed a single “DoD Financial Management Regulation” to be used on a DoD-wide basis. The Department has issued all 15 volumes as of March 1997. Fully implemented, the 15-volume Regulation replaces a myriad of existing policy guidance, clarify existing guidance where appropriate, and including additional guidance as needed.

In April 1995, the Office of General Counsel initiated a business process reengineering (BPR) study of the Garnishment Operations Directorate which was being consolidated at the DFAS Cleveland Center. The consolidation was completed in October 1996 and represents a commitment to streamline and standardize the processing of garnishment orders for child support, alimony, commercial debts, and divisions of retired pay pursuant to the Uniformed Services Former Spouses’ Protection Act. When consolidation began, we estimated a staffing level of 225 personnel, which included sufficient staff to accommodate the new workload attributable to garnishments and military involuntary allotments for commercial debts authorized by the Hatch Act Reform Amendments of 1993, Public Law No. 104-93. Upon completion of the BPR study, we estimated a staffing level of 125 personnel. As the Garnishment Operations Directorate implements the recommendations which emerged from the BPR study, the estimated staffing level has been reduced to 114 personnel. Those recommendations include enhancement to the payroll locator file system an “expert system,” development of an integrated garnishment system which interfaces with the pay systems, and development of an electronic document management (imaging) system.

In FY 1995, DFAS combined two Office of Management and Budget (OMB) reporting requirements in a single document—The Chief Financial Officer’s Act Financial Management Five-Year Plan. This plan reflected the OMB A-130 Information Management strategic plan requirement as well as the OMB A-127 and CFO Act Financial Management Five-Year Plan requirement. In FY 1996, we also combined the Federal Manager’s Financial Compliance Report into this plan. These reports were combined to eliminate redundancy and date-related conflicts.

In FY 1995, DFAS began a full and active OMB Circular A-76, Commercial Activities Program by initiating two studies in the areas of Debt and Claims Management and Facilities, Logistics, and Administration.

During FY 1996, the Debt and Claims Management study was terminated following an IRS ruling. DFAS, however, implemented the Government’s Most Efficient Organization (MEO), in May of 1997, consolidating the Debt and Claims Management functions at the Denver Center, and saving of over \$8.5 million annually.

The Facilities, Logistics, and Administration study, completed in May 1997, also resulted in the implementation of the Government’s MEO. The MEO, which will be fully implemented by the beginning of FY 1998, will garner an annual savings of over \$4 million. Currently DFAS has active A-76 studies in the areas of Defense Commissary Accounting and Vendor Pay, DoD Transportation Accounting, and DoD Depot Maintenance Accounting. These studies, which are scheduled for completion in FY 1998 and FY 1999, are expected to yield annual savings of over \$7 million. DFAS will continue to conduct A-76 studies in an effort to provide better service and reduce costs to its customers.

The Electronic Document Management (EDM) Program provides users with online access to financial documents and information, advances application of new methods and technologies, resolves management of large volumes of hard-copy documents, ensures the consistent implementation of business practices throughout DFAS, improves customer service and reduces operating costs. EDM involves the collective application of three technologies: imaging, electronic foldering, and workflow. Together, these technologies automate the presentation of material, the integration of business applications and the standardization of business processes. EDM has been successfully prototyped in the Vendor Pay area and is scheduled for deployment to additional DFAS Vendor Pay sites. For ease of development and deployment, EDM support for Contract Pay was separated into two releases. Release 1 supports contract input, and release 2 provides workflow. Release 1 has been successfully prototyped and is scheduled for deployment through the Columbus Center. Release 2 development and prototyping continues. EDM is also being developed to support Payroll Services and is being installed in the Garnishment Operations Directorate at the DFAS Cleveland Center. Further, the Program Manager continually evaluates other business operations which can benefit from the use of these technologies.

Overview

A major element of the EDM Program is Electronic Document Access (EDA), which uses Internet and World Wide Web (WWW) technology to share documents across the Department. DFAS has partnered with the Service and DoD Agency acquisition communities, the Defense Information Systems Agency (DISA), and the Defense Automated Printing Service (DAPS) to develop and implement an Intranet application that assures DoD wide, online access to contracts and other documents stored at remote locations. EDA offers read-only access to official contract documents in a common file format that minimizes the need for DoD users to maintain hard-copy files. With the early success of contracts and Government Bill of Lading (GBLs) on the web, EDA is being expanded to include payment vouchers and contract deficiency reports. In addition, we are continually evaluating new document types for inclusion in the EDA effort.

DFAS has established an Electronic Commerce Program Office to identify and implement EC/EDI and Electronic Funds Transfer (EFT) across the financial management community. Some of the highest EC/EDI priorities include: develop electronic processes to validate funds and record commitments in the accounting systems; create electronic contracts and contract modifications in the contract writing systems and record them in the payment and accounting systems; process electronic receiving reports to the payment and accounting systems; accept and process electronic invoices from vendors in the payment systems and automate the pre-validation of payments against obligations prior to disbursement. In addition, the project will increase the use of EFT, register small vendors to accept EC/EDI, and establish DoD standard implementation conventions for the financial community. Most of the Department's major vendor payment systems today already are transmitting EFT payments.

Another important example of DoD reengineering involves the government-wide purchase card known as the Government Purchase Card. This program is playing a major role in the Department's efforts to streamline the acquisition process and cut the costs of performing finance and accounting support for processing commercial invoices. The program allows individual government cardholders, using a Government Purchase Credit Card, to purchase items or services -- primarily those \$2,500 or less called "micro purchases"-- from vendors. Under the current government-wide contract, the First Bank System reimburses the individual vendors for these purchases and the Department makes consolidated payments to First Bank.

In 1996, DFAS processed about 9.9 million commercial invoices per year. Although an estimated 7.7 million invoices met the micro-purchase threshold, only about 1.2 million of these invoices were associated with the use of the Government Purchase Card.

The Department currently is reengineering its policies and procedures on using the charge card. Many of the acquisition pre-approvals and procedures are being streamlined. The Government Purchase Card Program, as it is known today, is expected to result in a faster and simpler procurement process, faster payments to the vendors, faster processing of commercial invoices, and a reduction in workload for processing financial and procurement documents. This is a win-win situation. The government is able to procure its needs quicker and easier; the commercial vendors are reimbursed faster; and interest payments are virtually eliminated. These

changes should result in an overall reduction in costs to the government both in dollars and manpower.

The acquisition changes will be accompanied by other changes in the finance and accounting world. Procedural changes and reengineering business practices by DFAS and DoD customers will increase the use of the charge card and generate millions of dollars of savings within the Department.

Reengineering practices include:

- Use of bulk commitments and/or obligations in the accounting systems for micro-purchases.
- Use of summary level accounting in the vendor pay systems for groups of purchases instead of detailed lines of accounting for each transaction or purchase.
- Use of an accelerated invoice reconciliation and certification process for disbursing against commercial invoices.
- Use of automated reconciliation systems available for customers to track individual micro-purchases against summary commercial invoice data.

The Government Purchase Card reengineering initiative is consistent with the goals and objectives of the National Performance Review. The on-going changes will enhance the Department's ability to provide cheaper and better finance and accounting services to its customers.

Problem Disbursements

Under the direction of the Under Secretary of Defense (Comptroller), DFAS, in coordination with the affected DoD Components, established a project to reduce problem disbursements and in-transits. This effort focused on resolving existing unmatched transactions, negative unliquidated obligations and intransit transactions and on making improvements in existing procedures and systems to prevent the occurrence of these problems. The project had a goal of reducing problem disbursements and in-transits by approximately 50 percent by the summer of 1994. This goal was achieved through the joint efforts of all parties involved. On June 30, 1995, the Under Secretary of Defense (Comptroller) issued a comprehensive set of procedures for researching and correcting problem disbursements. Between June 1996 and August 1997, the total absolute value of Unmatched Disbursements and Negative Unliquidated Obligations was reduced by 19 percent from \$10.1 to \$8.2 billion. Additionally, aged intransits were reduced from a net value of \$5.5 to \$4.2 billion, a 24 percent drop since reporting aged intransit values was changed from modified absolute to net in May 1997.

Overview

Cross Disbursements

The DoD Cross Disbursement processing procedures were approved by OUSD(C) on February 28, 1996. Those procedures apply to all DoD Components and include cross disbursed cash transactions except, Interfund transactions, centralized transportation payments at the DFAS Indianapolis Center, and open allotment transactions. The DFAS goal, as related to Cross Disbursements, is to significantly reduce and eliminate cross disbursements through accounting systems enhancements, including the elimination of paper flow within the DFAS network.

In an effort to improve the disbursement process so as to minimize in-transit disbursements, DFAS has developed short and long-term solutions to eliminate in-transits.

In the short-term, DFAS is converting business processes that produce “for others” transactions to processes that produce “for self” transactions. One example is the implementation of Transactions for Others (TFO) Cells for vendor payments. This process allows payments to be prepared and collected at one accounting office and disbursed by another accounting office, thus simultaneously updating the accounting records. In addition, to improve the timeliness of recording in-transits, DFAS is implementing automated processes to electronically transmit collections, disbursements, and reimbursables between DFAS accounting offices.

In the long-term, DFAS will prevalidate every disbursement to ensure the payment can be matched to an obligation before the payment is made. The Department is gradually lowering the threshold to zero for all payments. Further, DFAS is testing a system to route the relevant accounting data from a disbursing process to the relevant accounting office. This process will improve the accuracy of the data through edit criteria and the timeliness of updating the accounting records.

CFO Reporting

DFAS has a major responsibility to ensure that accurate, consistent and auditable FY 1997 CFO Financial Statements are prepared. DFAS has taken action for the preparation of standard CFO financial statements and footnotes across the DoD. DFAS has also implemented the Statement of Federal Financial Accounting Standard Number 5, Accounting for Liabilities of the Federal Government, in the FY 1997 CFO statements.

The DFAS Indianapolis Center provides special support to the DoD Chief Financial Officer. This support includes the preparation of the DoD Agency-wide consolidated financial statements, supporting schedules and notes. The DFAS Indianapolis Center also provided automated templates to the DFAS Centers and other customers for the preparation of 17 DoD CFO reports. These templates were developed to improve accuracy, ensure standardization and provide a more efficient and timely process for the submission of the FY 1997 CFO statements.

DFAS hosted the first DoD CFO Workshop in May 1997 with representatives from all functional areas involved in the CFO reporting process. These representatives included DFAS, our customers, the audit community, and the Office of Deputy Chief Financial Officers (ODCFO). The issues addressed during the workshop included numerous areas of concern and lessons learned from the FY 1996 CFO reporting process.

Throughout the year, DFAS continues to work with our customers, the ODCFO (Accounting Policy), and the audit community to improve the CFO reporting guidance, requirements, process, and schedule. This working relationship should improve the quality and timeliness of the CFO statements for the DoD.

To improve future CFO reporting DFAS has established a CFO After Action Report, which will identify the lessons learned, the planned versus actual completion dates of required CFO actions, and policy issues that require resolution before the next CFO reporting process.

Proactive Fraud Detection and Prevention

Operation Mongoose is DoD's fraud detection and prevention unit. It was established to minimize fraud against DoD financial assets. Operation Mongoose is managed by a DFAS program management team and involves several other DoD organizations. Computer matching techniques are used to compare various dissimilar computer systems operated by financial organizations within the Department to identify anomalies that occur when data that should be the same fails to match from one system to another. Operation Mongoose areas of current interest include validation of vendor payments, military, civilian, and retired/annuitant payrolls, transportation payments, and payment system intrusion.

The Operation Mongoose methodology includes the combined team efforts of the DFAS, the Defense Manpower Data Center (DMDC) in Monterey, California, and the DoD Inspector Generals Office, including the Defense Criminal Investigative Service (DCIS). These three organizations are working together to develop fraud indicators that are generated by the discrepancies between systems, collect and compare data from all over DoD, detect the presence of anomalies within the DoD systems, examine the appropriate records to determine if the anomalies actually are a result of fraud, and pursue criminal charges against the people responsible for the fraud. The objective is to establish a permanently structured organization that will detect and prevent fraud by actively seeking it out, rather than waiting for it to surface by chance, be identified by informants, or be detected by random reviews that allow too great an opportunity for concealment of the crime.

The Operation Mongoose program manager has established a network that includes personnel already in place at the DFAS Centers, especially in their internal review organizations, in DoD financial and law enforcement agencies, and in several outside agencies including the U. S. Secret Service. Operation Mongoose conducts proactive reviews of payments in five functional pay areas -- retiree/annuitants, civilian, military, vendor, and transportation. The

Overview

reviews have resulted in the elimination of millions of dollars of suspected fraudulent and erroneous regular payments. Operation Mongoose is presently in the process of completing the development of a tracking and reporting system that will increase the ability to monitor and control the cases under consideration and keep of responsible organizations informed of the investigation's status.

Finance and Accounting Initiatives:

DFAS will modify, as necessary, and deploy standard finance and accounting systems for use DoD-wide. Standard migration systems will evolve incrementally into a vision-driven financial management system able to support decision-making by all DoD managers and operating activities. Through these initiatives, DFAS expects increased standardization of DoD finance and accounting systems over the next five years, resulting in substantial savings for the taxpayer.

The DFAS Five-Year Plan is to systematically streamline the finance and accounting process by reducing the number of applications within the Defense environment. The following chart provides an overview of our current status and goals:

DoD Accounting and Finance System Inventory

| | <u>FY 91</u> | <u>FY 92</u> | <u>FY 93</u> | <u>FY 94</u> | <u>FY 95</u> | <u>FY 96</u> | <u>FY 97</u> |
|-----------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Accounting | 197 | 192 | 176 | 173 | 164 | 150 | 122 |
| Finance | <u>127</u> | <u>120</u> | <u>102</u> | <u>97</u> | <u>92</u> | <u>67</u> | <u>34</u> |
| Total | 324 | 312 | 278 | 270 | 256 | 217 | 156 |
| Reduction(cumulative) | | 12 | 46 | 54 | 68 | 107 | 168 |
| Percent (cumulative) | | 4% | 14% | 17% | 21% | 33% | 52% |

Accounting Systems

DFAS has undertaken a major effort toward reducing the number of DoD accounting systems and improving their compliance with Federal requirements. When DFAS was established, installation level accounting generally was performed at various military installations in decentralized field activity offices, using a variety of financial management information systems. These systems were tailored to meet the needs of the many diverse activities and frequently were integrated with the business operations that the applicable activities performed.

The complexity of accounting operations and the wide variety of automated information systems currently in use has shaped the Department's plan for migrating to standard DoD accounting systems.

By the end of FY 1997, DFAS had reduced the number of accounting systems to 122 from a high of 197 in FY 1991. This reduction was accomplished through the elimination and consolidation of 75 redundant and duplicative systems. DFAS will reduce the number of accounting systems to no more than 23 by FY 2003.

On April 17, 1996, DFAS established a Defense Accounting System Project Management Office (DAS PMO). The DAS PMO is responsible for all migratory, interim migratory, and legacy accounting systems that DFAS owns and operates. The DAS PMO mission is to manage the reduction of existing accounting systems. The DFAS goal throughout this process is to provide accurate, timely and effective customer support at the lowest possible cost. The overall objective is to field electronically linked accounting systems that comply with generally accepted government accounting principles and standards, comply with the Chief Financial Officer's Act of 1990, and produce complete and accurate installation, command, DoD Component and departmental-level accounting reports and financial statements. The mission includes the elimination of unneeded or obsolete legacy systems and the modification of systems, where necessary, to meet accounting system requirements. Specific objectives of the DAS PMO are to:

- Design the optimum system architecture and reduce costs and manpower necessary to operate and maintain accounting systems.
- Interface or integrate accounting systems with other accounting, pay, and reporting systems.
- Replace current legacy systems throughout the Department with standard consolidated systems using technologically advanced data processing techniques and telecommunications capabilities.
- Standardize accounting data and processes, where appropriate.

Overview

Accounting Systems By Category (as of FY 1997)

Accounting Systems

| | |
|--------------------------|-----------|
| - Working Capital Funds | 53 |
| - General Funds | 31 |
| - Foreign Military Sales | 9 |
| - Departmental Reporting | 9 |
| - Cash Accountability | 8 |
| - Non-appropriated Funds | 10 |
| - Trust Funds | 2 |
| Total | <hr/> 122 |

Finance Systems

DFAS has made substantial progress toward the consolidation and standardization of financial systems. DFAS financial systems are being consolidated and modified to meet DoD requirements. DFAS already has consolidated retiree and annuitant pay operations on one standard system—the Defense Retiree and Annuitant Pay System, with a resulting cost reduction of \$10 million per year. DFAS also has implemented a standard system and consolidated operating locations for its out-of-service debt management functions. System costs were reduced by \$1 million per year while the consolidated operation resulted in a \$8.5 million annual savings. Travel computation software was standardized across the DFAS, Defense Agencies, and all Military Services when version 5.0 of the Integrated Automated Travel System was distributed in September 1997. DFAS has consolidated the printing of all savings bonds for the Department from over 190 bond issuing sites, using 20 different systems, to two DFAS Centers, using one system. DFAS also has a standard automated process of safekeeping savings bonds for active duty military members. DFAS has nearly completed implementation of a standard system for processing civilian pay - the Defense Civilian Pay System (DCPS). This initiative has allowed the Department to close 348 payroll offices and eliminate 25 of the original 27 civilian pay systems. Over 703,000 civilians are paid using DCPS. By mid-1998, the Department will operate only one civilian pay system. This will reduce the monthly cost of maintaining civilian pay accounts by over 35 percent between FY 1995 and FY 1997. The Department also has made substantial progress in moving to standard military pay systems, eliminating 17 of its former 22 military pay systems. The active component of Navy will move to the standard Defense Joint Military Pay System in 1998 and the Reserve component will move in 1999. By the end of FY 2001, the Department will operate only two military pay systems.

Financial Systems By Category
(as of FY 1997)

Finance Systems

| | |
|------------------------|-----------|
| - Civilian Pay | 2 |
| - Military/Retired Pay | 12 |
| - Disbursing | 6 |
| - Transportation Pay | 3 |
| - Contract/Vendor Pay | 6 |
| - Travel Pay | 4 |
| - Debt Management | 1 |
| Total | <u>34</u> |

Some specific achievements are discussed as follows:

Defense Civilian Pay System (DCPS)

Approximately 770,000 DoD civilian employees and 2,000 Executive Office of the President employees are paid through two systems from four DFAS locations. This is a substantial reduction in the original number of 27 systems and over 350 payroll offices that were required before the Department began to standardize finance and accounting operations and systems. Over 703,000 employees currently are paid using the Defense Civilian Pay System (DCPS) from the DFAS Denver Center and the DFAS Operating Locations in Charleston, S.C., and Pensacola, Fla. Approximately 67,000 employees are paid using the Defense Business Management System (DBMS) from the DFAS Columbus Center. In addition, the National Security Agency operates DCPS software to pay its own employees and other components of the DoD intelligence community. All civilian payroll accounts are scheduled to convert to DCPS by May 1998.

For FY 1997, DFAS has standardized and incorporated foreign allowance entitlement procedures and processing within DCPS to support civilian employees located in the European and Pacific theaters. Using the previously developed concept of operations for foreign allowances as the basis, this replaces the many local, nonstandard payment practices for temporary subsistence quarters allowance, living quarters allowance, post allowance, pay advances, and other allowances authorized by the Department of State. In addition to automating these allowances within DCPS, the Defense Civilian Personnel Data System was modified to incorporate the same allowances, which are included in the automated interface between the two systems. This action eliminates the need for the Human Resources community to forward hard-copy authorization of the allowances to payroll offices.

Overview

In addition to improvements for the payment of foreign allowances, DCPS has also been modified to include standard requirements for payment of employees of the Department of Defense Education Activity (DoDEA). These employees are educators and administrators located in DoDEA overseas schools whose pay and leave entitlements differ from other General Schedule or Wage Board employees. Their unique requirements include a daily pay rate, special one-time payments for duty performed outside of the classroom, and a leave system that provides additional entitlements beyond the usual federal annual and sick leave entitlements.

Defense Joint Military Pay (DJMS) System

DFAS has a strategic initiative to standardize and consolidate the automated systems that support military pay under two systems: the Defense Joint Military Pay System (DJMS) and Marine Corps Total Force System (MCTFS). All Army, Navy, and Air Force military pay functions will be under the DJMS. Because the Marine Corps has an integrated military personnel and pay system, its Active Duty and Reserve military pay are supported by MCTFS. Both DJMS and MCTFS will become a part of the Office of the Undersecretary of Defense for Personnel and Readiness (OUSDP&R) initiative to fully integrate personnel and pay in the Department of Defense. Significant savings are expected from standardizing military personnel and pay policies, procedures, and systems.

The Department's military pay operations support about 3 million uniformed men and women in the following categories, each with its own statutes, rules, regulations, and unique support structures: Active Duty, Reserve and National Guard, Academy Cadets and Midshipmen, Reserve Officer training Corps (ROTC), Junior Reserve Officer Training Corps (JROTC), and Armed Forces Health Professionals Scholarship Program (AFHPSP). About 1.5 million active duty personnel are paid twice a month (97 percent via EFT), while most of the other categories are paid on an "as required" basis.

Defense Retiree and Annuitant Pay System (DRAS)

All military retiree and annuitant pay has been consolidated into the Defense Retiree and Annuitant Pay System (DRAS), with all retirees paid at the DFAS Cleveland Center and all annuitants paid at DFAS Denver Center. This consolidation not only standardized policies and procedures across the Military Services, but most importantly, reduced the costs of maintaining multiple systems. The DRAS consolidation, completed on April 1, 1995 effectively replaced eight systems. To accommodate growth in the customer base, the Department continues enhancing technology and operations. In February 1996, a Business Process Review (BPR) of the DRAS electronic document management process was initiated. The purpose of this BPR is to develop options for implementing a standard business process to maximize automation and enhance the

workflow operations. Upon completion, the solution that meets and complements the processing operations at both DFAS Cleveland and Denver will be implemented.

Defense Travel System (DTS)

In 1995, DoD established a Travel Reengineering Task Force to streamline temporary duty travel. Based on the recommendations of the task force, the Deputy Secretary of Defense directed sweeping changes in the Department's travel processes. The first action was to establish a Reengineering Travel Transition Office to formulate policies and procedures for temporary duty travel. In September 1995, a Program Management Office was formed to design and acquire a new Defense Travel System. The Request for Proposals was released on June 30, 1997. Implementation of the new Defense Travel System (DTS), under the direction of the OUSD(C) Project Management Office (PMO), will begin in April 1998. The PMO will phase in the new system over a three year period. Target date for completion is April 2001.

Integrated Automated Travel System (IATS) 5.0, provides a standard travel computation system for the DFAS, Defense Agencies, and all Military Services. IATS 5.0 provides EFT and split disbursement capability among its many improvements over earlier versions. The Navy will deploy IATS 5.0 worldwide. During implementation of the DTS, IATS will continue to compute travel vouchers not covered under the DTS umbrella. As additional entitlement sections of the DoD travel regulations are simplified (i.e., reserve and permanent change of station), those types of travel will shift from IATS to DTS.

Defense Transportation Payment System (DTRS)

The Transportation Information Payment System was chosen as the standard DoD-wide transportation payment system on December 10, 1992. Renamed the Defense Transportation Payment System (DTRS), it supports the DoD initiative to consolidate and standardize transportation payments and will interface with the DoD standard accounting and disbursing systems. The DTRS includes the following features:

- Receives transportation GBL and invoices via EDI.
- Performs a prepayment audit of transportation bills.
- Disburses using EFT transfer technology.
- Manages claims and collections.

The implementation schedule for DTRS is currently under review.

Overview

Mechanization of Contract Administration Service (MOCAS)

Payments on approximately 96 percent of the 1.4 million invoices for the nearly 400,000 centrally-managed, high-dollar contracts are made by the DFAS Columbus Center. These payments are made primarily through an integrated contract management and payment system—MOCAS. Although MOCAS is no longer identified as the standard DoD contract payment migration system, it remains active and serves as the DoD contract payment legacy system. The proposed standardized DoD system for contract payments (under development) is the Defense Procurement Payment System (DPPS). One of the key elements of DPPS will be the systems integration with the Standard Procurement System, the Standard Logistics System, and the Shared Procurement Data Warehouse System. In addition to determining contractor entitlements and disbursing payments, the Columbus Center also builds and maintains the MOCAS database used by the DoD's contract administration community. Seventy percent of the dollar value of these major contracts is paid using EFT.

DFAS is also implementing EC/EDI in the contract pay area. Currently, efforts are underway to transmit contract data from four major contract writing systems to the contract payment system, MOCAS and seven accounting systems. This automated effort will eliminate duplicate data entry and provide timely distribution of contract and financial information. In addition, MOCAS has the capability of receiving contractor invoices transmitted via EDI. This effort will reduce the duplication of input by DFAS personnel and input errors.

Defense Debt Management System (DDMS)

Debt management is an integral part of current military pay, retiree and annuitant pay, civilian pay, travel pay, and disbursing systems for those individuals "in-service" owing money to the government. Similarly, for contractor debts, initial debt collection activities are an integral part of current transportation payment, vendor payment, and contract payment systems. Debt collection procedures are designated to facilitate the prompt collection of debts from individuals and contractors, while providing full due process in accordance with the Debt Collection Act of 1982. The debt collection process has been further improved with the implementation of the Debt Collection Improvement Act (DCIA) of 1996, which allows for the expeditious recovery of certain debts resulting from routine pay adjustments. DFAS currently accomplishes a myriad of file searches, data matches, and reconciliations both internal and external to DFAS pay systems. The purpose of these efforts are to detect potential overpayments, erroneous payments, and possible fraudulent activity; implement corrective actions; and collect resulting debts.

For individuals not receiving pay within the department (out-of-service), debt management is centralized at the DFAS Denver Center with over 200,000 cases processed annually. Delinquent contractor debts are managed at the DFAS Columbus Center with over 3,000 delinquent debts valued at over \$3.4 billion. It should be noted that approximately \$2.2 billion of the total contractor debt is currently identified as deferred, pending a decision by the Armed Services Board of Contract Appeals. Both of the above operations use the Defense Debt Management

System (DDMS), hosted at the DFAS Denver Center, to maintain and manage their debt portfolios. DDMS uses a wide range of collection techniques to collect DoD debt including: sending dunning letters to debtors, reporting delinquent debtors to credit bureaus, and referring delinquent debtors to collection agencies for collection assistance and to the Internal Revenue Service for offset against an individual's federal income tax refund. In FY97, DDMS recovered over \$208 million in individual and contractor debts due the Department. For FY98, the Department's delinquent debts will be included in the Treasury's National Delinquent Debtor Database (NID3) and will be matched against all available federal payments. This process will implement the administrative offset provision of the DCIA of 1996, providing yet another tool to increase debt collection within the federal government.

Manpower

DFAS has taken aggressive measures to respond favorably to the DoD manpower requirement to downsize both the military and civilian workyear levels. For the last four years, DFAS has exceeded the OUSD(C) mandatory civilian and military reduction goals.

The military and civilian workyears employed at DFAS as of September 30, 1997:

| | |
|----------|--------|
| Military | 1,467 |
| Civilian | 19,016 |

Organization:

DFAS Finance and Accounting Centers:

DFAS Headquarters, Arlington, VA.

DFAS Cleveland Center, Cleveland, OH.

DFAS Columbus Center, Columbus, OH.

DFAS Denver Center, Denver, CO.

DFAS Indianapolis Center, Indianapolis, IN.

DFAS Kansas City Center, Kansas City, MO.

Overview

In addition to its own operation, several Centers have responsibility for field locations throughout the United States. The following is the current Center responsibility list:

| <u>Responsible Center</u> | <u>Operating Location</u> |
|---------------------------|--|
| Cleveland | Charleston, SC Honolulu, HI Norfolk, VA Oakland, CA Pensacola, FL San Diego, CA |
| Denver | Dayton, OH Limestone, ME Omaha, NE San Antonio, TX San Bernadino, CA |
| Indianapolis | Orlando, FL Lawton, OK Rock Island, IL Seaside, CA St. Louis, MO Rome, NY |

A standard operational structure aids the implementation of new technologies and business practices. Thus, DFAS OPLOCs, which focus primarily on installation accounting and vendor pay, have standard organizations and procedures. In addition to a director and principal deputy director, each OPLOC has three Deputates: accounting, finance, and administration. The three OPLOCs with civilian pay functions also have civilian pay Deputates.

At the end of FY 1997, DFAS opened 17 of 21 planned OPLOCs and closed 307 of the 332 field activities. Consolidation of field activities into no more than 24 sites is scheduled for completion by July 1998. Studies are underway to consolidate overseas locations.

All the above activities directly support major DFAS programs, promoting effective and efficient finance and accounting services during times of peace and conflict.

Fiscal Year 1997

Total FY 1997 DFAS revenue for the Financial Operations business area was \$1.770 billion, a 7 percent increase from the FY 1996 level of \$1.654 billion. Expenses remain static at \$1.642 billion in FY 1996 and \$1.645 billion in FY 1997. DFAS achieved significant cost reductions in FY 1997, which are masked by inflation and increased costs for GSA rental

payments and depreciation expenses for capital investments. When these costs are netted from the total, the DFAS costs decreased by approximately \$60 million from FY 1996 to FY 1997.

Source of Funds

During FY 1997, the principal source of funds for DFAS was revenue received from DoD components for which DFAS performed finance and accounting services. The sources of DFAS revenue were as follows:

| | Amount (Dollars in Millions) |
|------------------|---------------------------------|
| Army | \$632.5 |
| Air Force | 343.9 |
| Navy | 408.0 |
| Marine Corps | 78.3 |
| Defense Agencies | 263.9 |
| FMS | 43.3 |
| Total | \$1,769.9 |

DFAS Earned Authority

| | (Dollars in Millions) |
|-----------------------------|-----------------------|
| Total Earned Authority | \$1,719.4 |
| Total Expenses | \$1,645.0 |
| Difference | \$74.4 |
| Percent of Earned Authority | 95.7% |

In FY 1997 as in FY 1996, DFAS successfully executed its mission at total costs well below its available earned authority, reflecting the Agency's continuing efforts to control costs. For the majority of output measures, costs were either under or slightly above the target. Three targets showed significant overages: Military Pay Incremental, Transportation Bills Paid, and Commercial Invoices.

The unit cost target for Military Pay Incremental did not include the anticipated costs for the Army Tactical Units. These costs were spread as General and Administrative to all the DFAS unit cost targets instead of directly to Military Pay Incremental. When these costs were properly allocated, costs for Military Pay Incremental went up while other outputs decreased. The cost target for Transportation Bills Paid included projected savings from system enhancements. Delays in the implementation of the enhancements prevented the realization of the projected cost

Overview

reductions. As a result cost savings did not occur, and the target was exceeded. The unit cost variance for Commercial Invoices is due to reduced workload volume as workload was realigned from Defense Accounting Offices (DAOs) to Operating Locations (OPLOCs). It should be noted the total costs for Commercial Invoices dropped \$5 million from FY 1996.

DFAS has been studying an alternative way to measure the costs of accounting services. Currently, most of these costs are captured in Monthly Trial Balances Maintained output. DFAS is reviewing the use of billable hours as a better means of capturing and evaluating accounting costs. Initial testing of Direct Billable Hours (DBH) began in FY 1997. Testing will continue into FY 1999, with a proposal to implement the use of DBH in FY 2000. DFAS is also continuing to explore ways to pass on savings to our customers from new technologies like electronic commerce and through improved business practices like the use of the purchase card. Incentive rates have been proposed for use of electronic commerce in the areas of Commercial Invoices Paid - Mechanization of Contract Administration Services, Commercial Invoices Paid - Standard Automated Material Management System, and Travel Vouchers Paid. Additionally, the use of the DoD Purchase card is projected to provide dramatic savings in the future as it is implemented by our customers.

DFAS Issues to the Year 2000 and beyond

DFAS is a service organization and must be flexible to meet the changing needs of customers supported with efficient operations in peacetime and the ability to expand rapidly to meet any type of military emergency. As the size of the military establishment is reduced, the workload of DFAS will also be reduced. Major efforts will be required to adjust operations to produce cost effective products that are required by law or for which customers are willing to pay.

The finance and accounting business processes are being revolutionized in the 1990s, both vertically within the finance and accounting functional areas and laterally across functional lines. The business processes are being improved on a phased basis in conjunction with fielding migratory systems and evolving new systems, and implementing corporate information management functional requirements and concepts. Finance and accounting systems are being standardized and integrated and operations will be centralized at a small number of locations. Use of technology is being applied to reduce or eliminate paper and improve efficiency. At the same time, the quality of service and internal controls is being improved.

A major challenge is down sizing staff with minimum impact on people and operations while upgrading the qualification of the remaining work force. With so much change both within DFAS and the organizations it serves, extraordinary measures are being taken to avoid problems in internal controls and services as standard migratory systems are implemented and operations are relocated to central sites.

DFAS has made significant progress within the past seven years towards consolidating and standardizing finance and accounting within DoD, but much remains to be done to achieve financial management reform. Major challenges still lie ahead. DFAS will play a key role in the DoD-wide efforts in future financial management challenges.

Overview

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***DEFENSE FINANCE
AND
ACCOUNTING SERVICE

WORKING CAPITAL
FUND

FINANCIAL OPERATIONS

PRINCIPAL STATEMENTS***

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund (5L)
Statement of Financial Position
As of September 30, 1997
(Thousands)

| ASSETS | <u>1997</u> | <u>1996</u> |
|--|--------------------|--------------------|
| 1. Entity Assets: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balance with Treasury (Note 2) | \$65,227 | (\$57,647) |
| (2) Investments, Net (Note 4) | 0 | 0 |
| (3) Accounts Receivable, Net (Note 5) | 27,428 | 53,640 |
| (4) Interest Receivable | 0 | 0 |
| (5) Advances and Prepayments | 0 | 0 |
| (6) Other Federal (Intragovernmental) (Note 6) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Investments (Note 4) | 0 | 0 |
| (2) Accounts Receivable, Net (Note 5) | 118 | 37 |
| (3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7) | 0 | 0 |
| (4) Interest Receivable, Net | 0 | 0 |
| (5) Advances and Prepayments | 692 | 1,035 |
| (6) Other Non-Federal (Governmental) (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Inventory, Net (Note 8) | 0 | 0 |
| e. Work in Process (Note 9) | 0 | 0 |
| f. Operating Materials/Supplies, Net (Note 10) | 0 | 0 |
| g. Stockpile Materials, Net (Note 11) | 0 | 0 |
| h. Seized Property (Note 12) | 0 | 0 |
| i. Forfeited Property, Net (Note 13) | 0 | 0 |
| j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14) | 0 | 0 |
| k. Property, Plant and Equipment, Net (Note 15) | 571,371 | 494,547 |
| l. War Reserves | 0 | 0 |
| m. Other Entity Assets | 37,539 | 411 |
| n. Total Entity Assets | \$702,375 | \$492,023 |
| 2. Non-Entity Assets: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balance with Treasury (Note 2) | \$0 | \$0 |
| (2) Accounts Receivable, Net (Note 5) | 0 | 0 |
| (3) Interest Receivable, Net | 0 | 0 |
| (4) Other (Note 6) | 0 | 0 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund (5L)
 Statement of Financial Position
 As of September 30, 1997
 (Thousands)

| ASSETS, Continued | <u>1997</u> | <u>1996</u> |
|---|-----------------------------|-----------------------------|
| 2. Non-Entity Assets: | | |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Receivable, Net (Note 5) | \$0 | \$0 |
| (2) Interest Receivable, Net | 0 | 0 |
| (3) Other (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Other Non-Entity Assets | 0 | 0 |
| e. Total Non-Entity Assets | <u>\$0</u> | <u>\$0</u> |
| 3. Total Assets | <u><u>\$702,375</u></u> | <u><u>\$492,023</u></u> |
| LIABILITIES | | |
| 4. Liabilities Covered by Budgetary Resources: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | \$185,276 | \$194,532 |
| (2) Interest Payable | 0 | 0 |
| (3) Debt (Note 16) | 0 | 0 |
| (4) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 257,860 | 262,941 |
| (2) Accrued Payroll and Benefits | | |
| (a) Salaries and Wages | 7,570 | 3,360 |
| (b) Annual Accrued Leave | 384 | 384 |
| (c) Severance Pay and Separation Allowance | 0 | 0 |
| (3) Interest Payable | 0 | 250 |
| (4) Liabilities for Loan Guarantees (Note 7) | 0 | 0 |
| (5) Lease Liabilities (Note 18) | 0 | 0 |
| (6) Pensions and Other Actuarial Liabilities (Note 19) | 0 | 0 |
| (7) Other Non-Federal (Governmental) Liabilities (Note 17) | 0 | 0 |
| c. Total Liabilities Covered by Budgetary Resources: | <u><u>\$451,090</u></u> | <u><u>\$461,467</u></u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund (5L)
 Statement of Financial Position
 As of September 30, 1997
 (Thousands)

| LIABILITIES, Continued | <u>1997</u> | <u>1996</u> |
|--|-----------------------------|-----------------------------|
| 5. Liabilities Not Covered by Budgetary Resources: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | \$0 | \$0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 0 | 0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Lease Liabilities (Note 18) | 0 | 0 |
| (4) Pensions and Other Actuarial Liabilities (Note 19) | 0 | 0 |
| (5) Other Non-Federal (Governmental) Liabilities (Note 17) | 48,843 | 49,673 |
| c. Total Liabilities Not Covered by Budgetary Resources | <u>\$48,843</u> | <u>\$49,673</u> |
| 6. Total Liabilities | <u>\$499,933</u> | <u>\$511,140</u> |
| NET POSITION (Note 20) | | |
| 7. Balances: | | |
| a. Unexpended Appropriations | \$0 | \$0 |
| b. Invested Capital | 66,228 | (26,915) |
| c. Cumulative Results of Operations | 185,057 | 57,471 |
| d. Other | 0 | 0 |
| e. Future Funding Requirements | (48,843) | (49,673) |
| f. Total Net Position | <u>\$202,442</u> | <u>(\$19,117)</u> |
| 8. Total Liabilities and Net Position | <u><u>\$702,375</u></u> | <u><u>\$492,023</u></u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund (5L)

Statement of Operations and Changes in Net Position

For the Period Ended September 30, 1997

(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|--------------------|--------------------|
| REVENUES AND FINANCING SOURCES | | |
| 1. Appropriated Capital Used | \$0 | \$0 |
| 2. Revenues from Sales of Goods and Services | | |
| a. To the Public | 329 | 0 |
| b. Intragovernmental | 1,769,620 | 1,619,514 |
| 3. Interest and Penalties, Non-Federal | 0 | 0 |
| 4. Interest, Federal | 0 | 0 |
| 5. Taxes (Note 21) | 0 | 0 |
| 6. Other Revenues and Financing Sources (Note 22) | 0 | 33,961 |
| 7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies | 0 | 0 |
| 8. Total Revenues and Financing Sources | <u>\$1,769,949</u> | <u>\$1,653,475</u> |
| EXPENSES | | |
| 9. Program or Operating Expenses (Note 23) | \$0 | \$0 |
| 10. Cost of Goods Sold (Note 24) | | |
| a. To the Public | 0 | 0 |
| b. Intragovernmental | 1,507,944 | 1,526,921 |
| 11. Depreciation and Amortization | 137,466 | 114,341 |
| 12. Bad Debts and Writeoffs | 0 | 0 |
| 13. Interest | | |
| a. Federal Financing Bank/Treasury Borrowing | 0 | 0 |
| b. Federal Securities | 0 | 0 |
| c. Other | 0 | 0 |
| 14. Other Expenses (Note 25) | 0 | 384 |
| 15. Total Expenses | <u>\$1,645,410</u> | <u>\$1,641,646</u> |
| 16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items | \$124,539 | \$11,829 |
| 17. Plus (Minus) Extraordinary Items (Note 26) | <u>0</u> | <u>0</u> |
| 18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | <u>\$124,539</u> | <u>\$11,829</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund (5L)
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|-------------------|-------------------|
| EXPENSES, Continued | | |
| 19. Net Position, Beginning Balance, as Previously Stated | (\$19,117) | \$275,743 |
| 20. Adjustments (Note 27) | 0 | 33 |
| 21. Net Position, Beginning Balance, as Restated | <u>(\$19,117)</u> | <u>\$275,776</u> |
| 22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | 124,539 | 11,829 |
| 23. Plus (Minus) Non Operating Changes (Note 28) | 97,020 | (306,722) |
| 24. Net Position, Ending Balance | <u>\$202,442</u> | <u>(\$19,117)</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund (5L)

Statement of Cash Flows

For the Period Ended September 30, 1997

(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|--------------------|--------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| 1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | <u>\$124,539</u> | <u>\$11,829</u> |
| Adjustments Affecting Cash Flow: | | |
| 2. Appropriated Capital Used | 0 | 0 |
| 3. Decrease (Increase) in Accounts Receivable | 26,131 | (28,874) |
| 4. Decrease (Increase) in Other Assets | 343 | (255) |
| 5. Increase (Decrease) in Accounts Payable | (14,638) | 51,299 |
| 6. Increase (Decrease) in Other Liabilities | 4,597 | (4,832) |
| 7. Depreciation and Amortization | 137,466 | 114,341 |
| 8. Other Unfunded Expenses | 420 | 0 |
| 9. Other Adjustments | 2,472 | 250 |
| 10. Total Adjustments | <u>\$156,791</u> | <u>\$131,929</u> |
| 11. Net Cash Provided (Used) by Operating Activities | <u>\$281,330</u> | <u>\$143,758</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| 12. Sale of Property, Plant and Equipment | \$0 | \$0 |
| 13. Purchase of Property, Plant and Equipment | (216,103) | (201,405) |
| 14. Sale of Securities | 0 | 0 |
| 15. Purchase of Securities | 0 | 0 |
| 16. Collection of Loans Receivable | 0 | 0 |
| 17. Creation of Loans Receivable | 0 | 0 |
| 18. Other Investing Cash Provided (Used) | <u>0</u> | <u>0</u> |
| 19. Net Cash Provided (Used) by Investing Activities | <u>(\$216,103)</u> | <u>(\$201,405)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| 20. Appropriations (Current Warrants) | \$0 | \$0 |
| 21. Add: | | |
| a. Restorations | 0 | 0 |
| b. Transfers of Cash from Others | 0 | 0 |
| 22. Deduct: | | |
| a. Withdrawals | 0 | 0 |
| b. Transfers of Cash to Others | (57,647) | 309,913 |
| 23. Net Appropriations | <u>\$57,647</u> | <u>(\$309,913)</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund (5L)
Statement of Cash Flows
For the Period Ended September 30, 1997
(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|------------------------|--------------------------|
| CASH FLOWS FROM FINANCING ACTIVITIES, Continued | | |
| 24. Borrowing from the Public | \$0 | \$0 |
| 25. Repayments on Loans to the Public | 0 | 0 |
| 26. Borrowing from the Treasury and the Federal Financing Bank | 0 | 0 |
| 27. Repayments on Loans from the Treasury and the Federal Financing Bank | 0 | 0 |
| 28. Other Borrowings and Repayments | <u>0</u> | <u>0</u> |
| 29. Net Cash Provided (Used) by Financing Activities | <u>\$57,647</u> | <u>(\$309,913)</u> |
| 30. Net Cash Provided (Used) by Operating, Investing and Financing Activities | \$122,874 | (\$367,560) |
| 31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning | <u>(\$57,647)</u> | <u>309,913</u> |
| 32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending | <u><u>\$65,227</u></u> | <u><u>(\$57,647)</u></u> |

Supplemental Disclosure of Cash Flow Information:

| | <u>1997</u> | <u>1996</u> |
|-------------------------|--------------------|--------------------|
| 33. Total Interest Paid | \$437 | \$1,955 |

Supplemental Schedule of Financing and Investing Activity:

| | <u>1997</u> | <u>1996</u> |
|--|--------------------|--------------------|
| 34. Property and Equipment Acquired Under Capital Lease Obligations | \$0 | \$0 |
| 35. Property Acquired Under Long-Term Financing Arrangements | \$0 | \$0 |
| 36. Other Exchanges of Non-cash Assets or Liabilities | \$0 | \$0 |

The accompanying notes are an integral part of these statements.

Principal Statements

The accompanying notes are an integral part of these statements.

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE

WORKING CAPITAL
FUND

FINANCIAL OPERATIONS

FOOTNOTES
TO THE
PRINCIPAL STATEMENTS***

Footnotes

**DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
DEFENSE BUSINESS OPERATIONS FUND
FINANCIAL OPERATIONS
NOTES TO THE PRINCIPAL STATEMENTS
AS OF SEPTEMBER 30, 1997**

Note 1. Significant Accounting Policies

A. Basis of Presentation:

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the Department in accordance with DoD Guidance on Form and Content of Financial Statements For FY 1995/1996 Financial Activity (as adopted from FMR, Volume 6, Chapter 6 issued January 1998, "Form and Content of Audited Financial Statements") and DoD's accounting policies which are summarized in this note. These statements, therefore, are different from the financial reports, also prepared by the DoD pursuant to OMB directive, that are used to monitor and control DoD's use of budgetary resources.

B. Reporting Entity:

The Department of Defense (DoD) was created on September 18, 1947 by the National Security Act of 1947. The overall mission of the Department is to organize, train, and equip forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies.

On November 26, 1990, DoD Directive 5118.5, Defense Finance and Accounting Service established the Defense Finance and Accounting Service (DFAS) as an Agency of the Department of Defense (DoD) with responsibilities, functions, authorities, and relationships. The DFAS was established as an Agency of the DoD under the direction, authority and control of the Comptroller of the DoD. The primary responsibilities and functions included (1) DFAS shall direct finance and accounting requirements, systems, and functions for all appropriated, nonappropriated, working capital, revolving, and trust fund activities, including security assistance, (2) DFAS shall provide finance and accounting services for DoD Components and other Federal activities, as designated by the Comptroller, DoD, (3) DFAS shall execute statutory and regulatory financial reporting requirements and render financial statements, and (4) DFAS shall perform other functions as the Secretary of Defense, Deputy Secretary of Defense, or the Comptroller, DoD, may prescribe.

Footnotes

Fiscal Year 1997 represents the sixth full operational year for DFAS. Thus, these financial statements represent the sixth year that DFAS has prepared financial statements as required by the Chief Financial officers (CFO) Act. The CFO Act requires that the Defense Finance and Accounting Service prepare and have audited three consolidated financial statements: (1) Statement of Financial Position, (2) Statement of Operations, and (3) Statement of Cash Flows. The audited financial statements are presented on the accrual basis of accounting as required by General Accounting Office's Title 2, of the Policy and Procedures Manual for Guidance of Federal Agencies.

The Defense Business Management System (DBMS), an automated management information system, is used by the Agency to develop the financial and other managerial information. DBMS was designated as the migratory system for the Defense Business Operations Fund.

C. Budgets and Budgetary Accounting:

The Department expanded the use of professional financial management practices through the establishment of the Defense Working Capital Fund (formerly the Defense Business Operations Fund) on October 1, 1991. The Fund operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision-making process. The Fund builds on the revolving fund principles previously used for industrial and commercial-type activities.

The Agency's major budget activity is the financial operations business area operating under the Working Capital Fund (Account Symbol 97X4930.5L), a revolving fund.

D. Basis of Accounting:

Transactions are recorded on an accrual accounting basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Also, when costs are incurred on a relatively uniform basis over the life of an order, revenue may be recognized as a percentage of incurred costs to total projected costs. At a minimum, the customer shall be billed and revenue recognized at the end of each fiscal year quarter. In summary the Fund shall operate under financial policies and responsibilities currently in effect for stock and industrial funds, except as modified by DoD Comptroller policy documents.

E. Revenues and Other Financing Sources:

Revenue is earned and recognized when services are completed and billed or on a percentage of completion method.

For financial reporting purposes under accrual accounting, operating expenses are recognized in the period incurred. Expenditures for capital and other long-term assets are

received then capitalized when purchased, but are not depreciated until they are put into operation by the Department.

Prior to FY96, due to inadequate system support, the annual leave liability was treated as an unfunded liability and future funding requirements on the Statement of Financial Position. In FY96, it was determined that any increase to the annual leave account (GLAC 2300.000) between the FY95 and FY96 ending balances would be recorded on the Statement of Operations and Changes in Net Position as an expense and as a funded liability on the Statement of Financial Position. If the change in the FY97 and FY96 ending balances results in a decrease, the unfunded liability and future funding requirement on the Statement of Financial Position would be adjusted accordingly.

F. Accounting for Intra-governmental Activities:

DFAS, as the Department's accountant, interacts with the other DoD Components in a typical business manner, i.e. provides accounting service to the Program Managers and DoD Comptroller. Our service includes the accounting and finance service for approximately 300 fund accounts. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department or the Working Capital Fund. These statements reflect the Financial Operations business portion of the Working Capital Fund.

Like the other DoD Components, the DFAS employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while assigned military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security.

G. Funds with the U.S. Treasury and Cash:

The Agency's fund resources as part of the Working Capital Fund are maintained in the Treasury account. The Fund's cash receipts and disbursements are processed by the Treasury, and the balance with the Treasury represents the aggregate of all unexpended balances at the summary level.

H. Foreign Currency:

Not applicable.

I. Accounts Receivable:

As presented in the Statement of Financial Position, accounts receivable includes accounts, claims and refunds receivable and advance payments to other entities. Allowances for uncollectible accounts were established in FY 1994. Allowances for Bad Debts were determined in accordance with DoD 7220.9M and DFAS guidance. The total amount was recorded in the Allowance for Bad Debts account pending final write-off approval.

J. Loans Receivable:

Footnotes

Not Applicable.

K. Inventories:

Not Applicable.

L. Investments in U.S. Government Securities:

Not Applicable.

M. Property and Equipment:

All Defense Finance and Accounting Service property, plant and equipment is recorded in the Defense Property Accountability System (DPAS). The capital assets include, but are not limited to, physical plant and property, (including government owned facilities, property acquired under a capital lease or an operating lease), equipment and software. The assets were purchased with capital funds. For assets purchased with Fiscal Year 1992 and 1993 capital funds, the original purchase price (including installation and transportation costs) exceeded \$15,000. For assets purchased with Fiscal Year 1994 capital funds, the original purchase price exceeded \$25,000. For assets purchased with Fiscal Year 1995 and Fiscal Year 1996 capital funds, the original purchase price exceeded \$50,000.

DPAS was balanced and reconciled to the certified trial balances for fiscal year 1997. The largest component of property, plant, and equipment is ADP software with a Net Book Value of \$295,854. This account is understated and should read \$298,706. The correction to this account will occur in the FY98 Financial Statements. The Net Book Value for Fixed Assets (In-Use) is \$571,371.

Routine maintenance and repair costs are expensed when incurred. Depreciation of property and equipment is calculated on a straight line basis. Defense Finance and Accounting Service (DFAS) expensed \$137,466 in depreciation for this fiscal year and expensed 423,228 in depreciation from inception of the Defense Working Capital Fund (formerly the Defense Business Operation Fund). The accumulated depreciation which includes depreciation on assets transferred-in, from inception is \$496,414 (See Note 15 for the Book Value of DFAS's depreciated assets).

The General Accounting Office (GAO) has determined that real property used by the DWCF, but under the jurisdiction of the Military Departments, represents an asset of the DWCF and such property should be reported on the financial statements as an entity asset to show the full costs of all resources and assets used in DWCF operations.

N. Prepaid and Deferred Charges:

Not Applicable.

O. Leases:

Not Applicable.

P. Contingencies:

Not Applicable.

Q. Accrued Leave:

Civilian employee annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for the civilian annual leave and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of nonvested leave are expensed as taken. Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. DFAS has \$48,843 in Accrued Annual Leave that is reported as a liability not covered by current budgetary resources.

R. Equity:

Equity consists of invested capital, cumulative result of operations, and future funding requirements. Invested capital, as presented in the Statement of Financial Position, represents the net value of the capital asset transferred to or from the DFAS-Financial Operations and Financial Systems organization from or to other organizations.

Cumulative results of operations represents the excess of revenues over total expenses since the inception of the reporting entity, less refunds to customers and returns to the U. S. Treasury.

S. Aircraft/Ship Crashes:

Not Applicable.

T. Treaties for Use of Foreign Bases:

Not Applicable.

U. Comparative Data [for use by reporting entities preparing CFO financial statements for the first time]:

Footnotes

Not Applicable.

W. Undelivered Orders:

All DoD Components are obligated for goods and services which have been ordered but not yet received (undelivered orders) as of September 30, 1997. Aggregate undelivered orders amounted to \$22,074 as of September 30, 1997.

Note 2. Fund Balances with Treasury

A. Working Capital Fund (USD(C)) and All Other Funds and Accounts:

Not Applicable.

B. Working Capital Fund Activities Below (USD(C)) Level:

| | Entity Assets | |
|-------------------------------|------------------------|------------------------|
| | <u>Funds Collected</u> | <u>Funds Disbursed</u> |
| Beginning Balance | 1,590,881 | (1,682,489) |
| Transfers of Cash to Others | (1,590,881) | |
| Transfers of Cash from Others | | 1,682,489 |
| Funds Collected | 1,801,548 | |
| Funds Disbursed | | (1,736,321) |
| Ending Balance | <u>1,801,548</u> | <u>(1,736,321)</u> |

C. All Funds and Accounts:

Not Applicable.

D. Other Information:

Cash collections and disbursements data for the financial statements is obtained from the finance network/Cash Outlay System Report and Service listings. The difference between cash collections in the finance network/Cash Outlay System Report and the general ledger amounted to \$3,210. This amount is reported as an increase in accounts receivable. The difference between cash disbursements in the finance network/Cash Outlay System Report and the general ledger amounted to \$75,674. This amount is reported as an increase in accounts payable.

The current year undistributed amount for reimbursements was incorrectly reported as an increase to the trial balance amount. This amount should have been a decrease to the trial balance. The total collections should be \$1,795,036.

The disbursement amount should have read \$1,733,699. The difference between what was reported on the financial statements for disbursements and what should have been reported, was

due to using the Cash Listing vs. the Cash Outlay System. The Cash Outlay was unavailable at the time of producing these reports.

With the above changes, the total Fund Balance with Treasury amount should be \$61,337. Due to the timing in discovering these discrepancies, the adjustments were not made to the FY97 statements, but will be made on the FY98 statements.

Note 3. Cash, Foreign Currency and Other Monetary Assets

Not Applicable.

Note 4. Investments

Not Applicable.

Note 5. Accounts Receivable, Net

| | (1) Allowance Amount <u>Due</u> | (2) Allowance For Estimated <u>Uncollectibles</u> | (3) Method <u>Used</u> | (4) Amount <u>Due</u> |
|-----------------------------------|--|--|------------------------------|-----------------------------|
| A. Entity Receivables: | | | | |
| Intragovernmental | 28,007 | (113) | | 28,120 |
| Governmental | 118 | | | 118 |
| Total | 28,125 | (113) | | 28,238 |
| B. Non-Entity Receivables: | | | | |
| Intragovernmental | | | | |
| Governmental | | | | |

C. Other Information:

The Accounts Receivable Intragovernmental was increased by \$17,431 due to undistributed collections. Undistributed dollars are the difference between cash collections in the finance network/Cash Outlay System Report and the general ledger. The allowance for Accounts Receivables is for Refunds Receivable.

Accounts receivable may also include numerous over-aged and negative transactions. These transactions are currently under investigation for system and processing deficiencies.

Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets

Not Applicable.

Note 7. Loans and Loan Guarantees, Non-Federal Borrowers

Footnotes

Not Applicable.

Note 8. Inventory, Net

Not Applicable.

Note 9. Work in Process

Not Applicable.

Note 10. Operating Materials and Supplies (OM&S), Net

Not Applicable.

Note 11. Stockpile Materials Net

Not Applicable.

Note 12. Seized Property

Not Applicable.

Note 13. Forfeited Property, Net

Not Applicable.

Note 14. Goods Held Under Price Support and Stabilization Programs, Net

Not Applicable.

Note 15. Property, Plant, and Equipment, Net

| | (1) Depreci- ation <u>Method</u> | (2) Service <u>Life</u> | (3) Acquisition <u>Value</u> | (4) Accumulated <u>Depreciation</u> | (5) Net Book <u>Value</u> |
|--|---|-------------------------------|------------------------------------|---|------------------------------------|
| <u>Classes of Fixed Assets</u> | | | | | |
| A. Land | | | | | |
| B. Structures, Facilities, & Leasehold Improvements | S/L | 11-20 | 7,166 | 4,028 | 3,138 |
| C. Military Equipment | S/L | 1-5 | 3,489 | | 3,489 |
| D. ADP Software | S/L | 1-5 | 692,943 | 397,088 | 295,855 |
| E. Equipment | S/L | 1-5 | 109,018 | 72,591 | 36,427 |
| F. Assets Under Capital Lease | S/L | 1-5 | | | |
| G. Other | S/L | 1-5 | 26,046 | 22,708 | 3,338 |
| H. Natural Resources | | | | | |
| I. Construction-in-Progress | | | 229,124 | | 229,124 |
| Total | | | 1,067,786 | 496,415 | 571,371 |

*Keys:

| <u>Depreciation Methods</u> | <u>Range of Service Life</u> | |
|--|------------------------------|----------------|
| SL - Straight Line | 1-5 | 1 to 5 years |
| DD - Double-Declining Balance | 6-10 | 6 to 10 years |
| SY - Sum of the Years' Digits | 11-20 | 11 to 20 years |
| IN - Interest (sinking fund) | >20 | Over 20 years |
| PR - Production (activity or use method) | | |
| OT - Other (describe) | | |

J. Other Information:

ADP Software, Net is incorrectly understated by \$2,852. The correction for this error will be made on the FY98 financial statements.

Note 16. Debt

Not Applicable.

Footnotes

Note 17. Other Liabilities

A. Other Liabilities Covered by Budgetary Resources:

Not Applicable.

B. Other Information:

Not Applicable.

C. Other Liabilities Not Covered by Budgetary Resources:

| | Non-Current <u>Liability</u> | Current <u>Liability</u> | <u>Total</u> |
|--------------------------|---------------------------------|-----------------------------|---------------|
| 1. Intragovernmental | | | |
| (1) Accrued Annual Leave | 48,843 | | 48,843 |
| (2) _____ | | | |
| Total | <u>48,843</u> | <u> </u> | <u>48,843</u> |

Note 18. Leases

Not Applicable.

Note 19. Pensions and Other Actuarial Liabilities

Not Applicable.

Note 20. Net Position

| | Revolving <u>Funds</u> | Trust <u>Funds</u> | Appropriated <u>Funds</u> | <u>Total</u> |
|--|---------------------------|-----------------------|------------------------------|----------------|
| A. Unexpended Appropriations: | | | | |
| (1) Unobligated, | | | | |
| a. Available | | | | |
| b. Unavailable | | | | |
| (2) Undelivered Orders | | | | |
| B. Invested Capital | 66,228 | | | 66,228 |
| C. Cumulative Results of Operations | 185,057 | | | 185,057 |
| D. Other | | | | |
| E. Future Funding Requirements | (48,843) | | | (48,843) |
| F. Total | <u>202,442</u> | <u> </u> | <u> </u> | <u>202,442</u> |

Note 21. Taxes

Not Applicable.

Note 22. Other Revenues and Financing Sources

Not Applicable.

Note 23. Program or Operating Expenses

Not Applicable.

Note 24. Cost of Goods Sold Do A, B, or C as appropriate.**A. Cost of Services Sold:**

| | |
|--|-------------------------|
| (1) Beginning Work-in-Process | \$0 |
| (2) Plus: Operating Expenses | |
| (a) Personal Services and Benefits | 880,973 |
| (b) Travel and Transportation | 35,301 |
| (c) Rental, Communication and Utilities | 90,117 |
| (d) Printing and Reproduction | 18,600 |
| (e) Contractual Services | 432,945 |
| (f) Supplies and Materials | 16,933 |
| (g) Equipment not Capitalized | 30,662 |
| (h) Grants, Subsidies and Contributions | 1,556 |
| (i) Insurance Claims and Indemnities | |
| (j) Other (describe): | |
| (1) Interest Expense | 437 |
| (2) Real Property Maintenance | 396 |
| (3) Bad Debt | 24 |
| (j) Total Expenses by Object Class | 1,507,944 |
| (3) Minus: Ending Work-in-Process | |
| (4) Minus: Completed Work for Activity Retention | |
| Cost of Services Sold | <u><u>1,507,944</u></u> |

Note 25. Other Expenses

| | <u>1996/7</u> | <u>1995/6</u> |
|---------------------------|------------------------------------|-------------------|
| A. Other Expenses: | | |
| (1) Accrued Annual Leave | | 384 |
| Total | <u><u> </u></u> | <u><u>384</u></u> |

Footnotes

Note 26. Extraordinary Items

Not Applicable.

Note 27. Prior Period Adjustments

Not Applicable.

Note 28. Non-Operating Changes - (Transfers and Donations)

| | <u>1996/7</u> | <u>1995/6</u> |
|--|-----------------|--------------------|
| A. Increases: | | |
| (1) Transfers-In: | | |
| (a) Prior Year Cash Balance | (57,647) | (309,913) |
| (b) Capital Assets 9/30/97 | 108,701 | (45,966) |
| (2) Unexpended Appropriations | | |
| (3) Donations Received | | |
| (4) Other Increases | | |
| (5) Total Increases | <u>51,054</u> | <u>(355,878)</u> |
| | | |
| | <u>1996/7</u> | <u>1995/6</u> |
| B. Decreases: | | |
| (1) Transfers-Out: | | |
| (a) Capital Assets 9/30/96 | (45,966) | (49,157) |
| (2) Donations | | |
| (3) Other Decreases | | |
| (4) Total Decreases | <u>(45,966)</u> | <u>(49,157)</u> |
| C. Net Non-Operating Changes (Transfers): | <u>97,020</u> | <u>(\$306,721)</u> |

Note 29. Intrafund Elimination's

Footnotes

Schedule B: Eliminating Entries

| Selling Activity: | <u>Column A</u> <u>Accounts</u> <u>Receivable</u> | <u>Column B</u> <u>Revenue</u> | <u>Column C</u> <u>Unearned</u> <u>Revenue</u> | <u>Column D</u> <u>Collections</u> |
|--|---|-----------------------------------|--|---------------------------------------|
| Defense Finance and Accounting Service | 0.00 | 0.00 | 0.00 | 0.00 |
| TOTAL | 0.00 | 0.00 | 0.00 | 0.00 |

| Customer Activity: | <u>Column A</u> <u>Accounts</u> <u>Payable</u> | <u>Column B</u> <u>Expenses</u> | <u>Column C</u> <u>Advances</u> | <u>Column D</u> <u>Disbursements</u> |
|-----------------------------|--|------------------------------------|------------------------------------|---|
| (SRC/CD) | | | | |
| 100.00 Intra DLA Support | 0.00 | 0.00 | 0.00 | 0.00 |
| 417.00 DFAS Btwn DFAS | 0.00 | 0.00 | 0.00 | 0.00 |
| TOTAL | 0.00 | 0.00 | 0.00 | 0.00 |

Schedule C: Eliminating Entries

| Selling Activity: | <u>Column A</u> <u>Accounts</u> <u>Receivable</u> | <u>Column B</u> <u>Revenue</u> | <u>Column C</u> <u>Unearned</u> <u>Revenue</u> | <u>Column D</u> <u>Collections</u> |
|--|---|-----------------------------------|--|---------------------------------------|
| Defense Finance and Accounting Service | 8,541 | 1,724,646 | 0.00 | 1,754,341 |
| TOTAL | 8,541 | 1,724,646 | 0.00 | 1,754,341 |

| Customer Activity: | <u>Column A</u> <u>Accounts</u> <u>Payable</u> | <u>Column B</u> <u>Expenses</u> | <u>Column C</u> <u>Advances</u> | <u>Column D</u> <u>Disbursements</u> |
|---|--|------------------------------------|------------------------------------|---|
| (SRC/CD) | | | | |
| 411.00 Navy, Marine Corps | 2,583 | 521,583 | 0.00 | 530,564 |
| 412.00 Army | 3,328 | 672,081 | 0.00 | 683,653 |
| 416.00 Air Force | 1,768 | 357,011 | 0.00 | 363,158 |
| 414.00 DLA (Oth than 418) | 457 | 92,149 | 0.00 | 93,736 |
| 417.00 Other Def Agencies (Oth than DFAS) | 405 | 81,822 | 0.00 | 83,230 |
| TOTAL | 8,541 | 1,724,646 | 0.00 | 1,754,341 |

Schedule D: Eliminating Entries

Footnotes

| Selling Activity: | <u>Column A</u> <u>Accounts</u> <u>Receivable</u> | <u>Column B</u> <u>Revenue</u> | <u>Column C</u> <u>Unearned</u> <u>Revenue</u> | <u>Column D</u> <u>Collections</u> |
|---|---|-----------------------------------|--|---------------------------------------|
| Defense Finance and Accounting Service | 18,887 | 44,975 | 0.00 | 47,207 |
| TOTAL | 18,887 | 44,975 | 0.00 | 47,207 |

| Customer Activity: | <u>Column A</u> <u>Accounts</u> <u>Payable</u> | <u>Column B</u> <u>Expenses</u> | <u>Column C</u> <u>Advances</u> | <u>Column D</u> <u>Disbursements</u> |
|------------------------------------|--|------------------------------------|------------------------------------|---|
| (SRC/CD) | | | | |
| 300.00 Off Budget Federal Entities | 0.00 | 0.00 | 0.00 | 0.00 |
| 600.00 Foreign Military Sales | 1,315 | 44,630 | 0.00 | 43,724 |
| 822.00 All Others | 141 | 345 | 0.00 | 273 |
| Other | 17,431 | N/A | N/A | 3,210 |
| TOTAL | 18,887 | 44,975 | 0.00 | 47,207 |

E. Other Information:

Earnings were given at a detail level, thus, allowing DFAS-CO to show Expenses at the lowest Customer Activity level as shown above. However, Accounts Receivable and Collections are not reflected in the Trial a Balance using the same detail level source code, therefore, detail Accounts Payable and Disbursements had to be computed using a percentage of Earnings in order to be shown at the same Customer Activity level.

Note 30. Contingencies:

Not Applicable.

Note 31. Other Disclosures:

A. Annual Leave:

Prior to FY96, due to inadequate system support, the annual leave liability was treated as an unfunded liability and future funding requirements on the Statement of Financial Position. In FY9, it was determined that any increase to the annual leave account (GLAC 2300.000) between the FY95 and FY96 ending balances would be recorded on the Statement of Operations and Changes in Net Position as an expense and as a funded liability on the Statement of Financial Position. If the change in the FY97 and FY96 ending balances results in a decrease, the unfunded liability and future funding requirement on the Statement of Financial Position would be adjusted accordingly.

B. Unmatched Disbursements (UMDs), Negative Unliquidated Obligations (NULO), and Aged in-Transit Disbursements:

| Treasury Index 97 DFAS | September 1996 | September 1997 | Change | Percent Change |
|--------------------------------------|-------------------|-------------------|--------|----------------------|
| Unmatched Disbursements | 75,409 | 86,895 | 11,486 | 15.23% (Increase) |
| Negative Unliquidated Obligations | 2,115 | 2,782 | 667 | 31.54% (Increase) |
| Totals | 77,524 | 89,677 | 12,153 | 15.68% (Increase) |

C. Cumulative Results of Operations

Cumulative Results of Operations include a prior period adjustment of \$2,246,002.68. The computation used in arriving at this amount was incorrect. The correct amount should be:

| | |
|---|-----------------------|
| Trial Balance (GLAC 6200.000) | \$3,361,891.51 |
| Depreciation not recorded on 30 Sept Trial Balance | <u>2,690,017.78</u> |
| | \$6,051,909.29 |
| Less Real Property Maintenance recorded on financial statements in Prior Years | <u>2,917,876.41</u> |
| Corrected Prior Period Adjustment amount | <u>\$3,134,032.88</u> |

There will be a prior period increase made on the FY98 Financial Statements of \$888,030.20 in order to bring the Cumulative Results of Operations to its correct amount.

Footnotes

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

FINANCIAL OPERATIONS

***SUPPLEMENTAL FINANCIAL
AND MANAGEMENT
INFORMATION***

Program Performance Measures

Financial Attributes

Operating Costs Attributes
(In Millions of Dollars)

| | FY 1997 | FY 1996 |
|-----------------------------|----------------|------------------|
| Total Costs and Expenses | \$1,645.0 | \$1,641.7 |
| Revenues and Reimbursements | <u>1,769.9</u> | <u>\$1,653.5</u> |
| Net Operating Results | \$124.9 | \$11.8 |
| Percentage of Revenue | 7.6% | .7% |
| Percentage of Change | 9.58% | |

Operating Results Attribute
(In Millions of Dollars)

| | FY 1997 | FY 1996 |
|-----------------------------|----------------|----------------|
| Revenues | | |
| Federal Sources | \$1,769.9 | \$1,619.5 |
| Public Sources | | |
| Other | <u>.0</u> | <u>34.0</u> |
| Total Revenue | 1,769.9 | 1,653.5 |
| Expenses and Losses | \$1,645.0 | \$1,641.7 |
| Net Oper.Inc (Deficit) | <u>\$124.9</u> | <u>\$11.8</u> |
| Additional Appropriations | 0 | 0 |
| Operating Surplus (Deficit) | <u>\$124.9</u> | <u>\$11.8</u> |

**Operating Obligations Attribute
(In Thousands of Dollars)**

| | FY 1997 | FY 1996 |
|-----------------------------|----------------|----------------|
| 1 Total Current Assets * | \$93.5 | \$249.4 |
| 3 Total Current Liabilities | <u>\$451.1</u> | <u>\$461.5</u> |
| Curr. Asset to Curr. Liab. | 1 : 4.85 | 1: 1.85 |
| 2 Total Quick Assets * | \$93.5 | \$249.4 |
| 3 Total Current Liabilities | <u>\$451.1</u> | <u>\$511.1</u> |
| Acid Test Ratio | .21:1 | (.49):1 |

1 Total Current Assets consist of cash, accounts receivable, and inventories

2 Total Quick Assets consist of cash and accounts receivable.

3 Total Current Liabilities include accounts, notes, and other obligations payable within a year

**Financial Condition Attribute
(In Thousands of Dollars)**

| | FY 1997 | FY 1996 |
|------------------------------|--------------|--------------|
| Available Sources of Cash * | \$65.2 | \$252.3 * |
| Future Requirements for Cash | 499.9 | 511.1 |
| Cash Surplus (Shortfall) | (\$434.7) | (258.8) |
| Total Assets * | \$702.4 | \$744.3 |
| Total Liabilities | <u>499.9</u> | <u>511.1</u> |
| Asset to Debt Ratio | 1 : .69 | 1: .69 |

* Current DoD Policy required the Agency to transfer the FY 1995 ending cash balance of \$309.9M to the cash account maintained for the all Defense Agencies. This requirement distorts the Statement of Cash Flows and the Cash and Equity accounts on the Balance Sheet. The cash account maintained for DFAS by the Defense Logistics Agency at the end of FY 1996 was a positive funds balance of \$252.3M.

Performance Measure Indicators FY 97

On August 1, 1995, the Director of DFAS approved 36 significant Performance Measures / Indicators (PMI) which will serve as a repository for information that can be reported externally, when needed, or utilized by various level of the organization to determine how effectively DFAS satisfies its operational requirements. The accumulation of data has just started and insufficient data is available to provide meaningful analysis for all PMIs. However, because of DoD's interest, three PMIs: Contract Reconciliation and Close-outs; Negative Unliquidated Obligations (NULOs); and Unmatched Disbursements (UMDs); have been tracked a sufficient period of time to provide an insight as to how well DFAS has performed. The following graphs provide a graphic picture of DFAS' favorable performance during FY 1997:

DFAS Cross Disbursements As of September 30, 1997

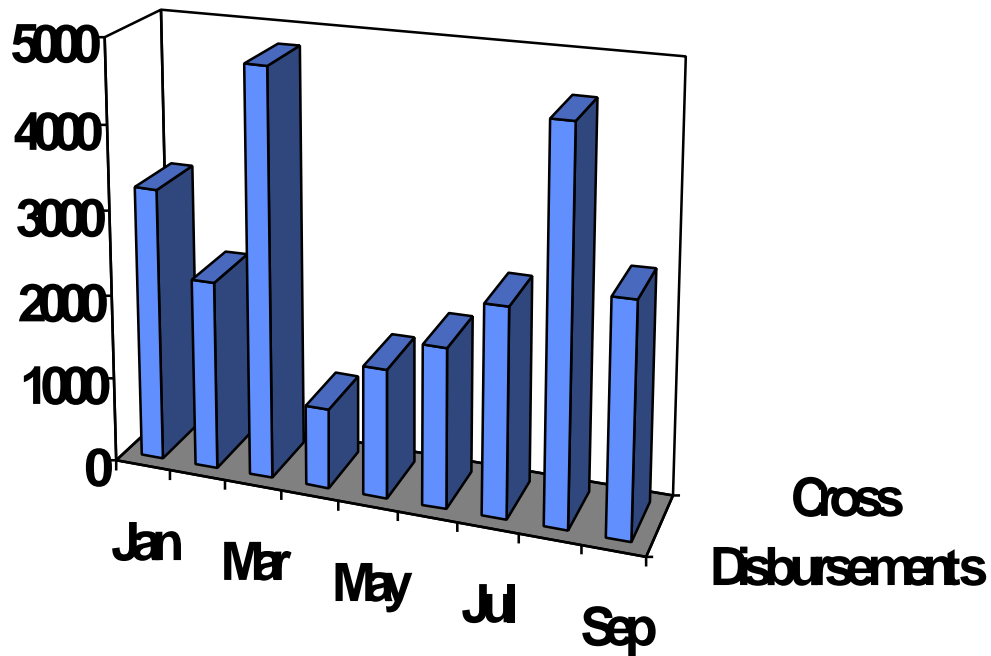
DFAS Center

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug* | Sep** |
|-----------------|-------|-------|-------|-----|-------|-------|-------|-------|-------|
| DFAS-FSO | 294 | 194 | 118 | 176 | 176 | 240 | 263 | 508 | 183 |
| DFAS-HQ | 82 | 29 | 56 | 21 | 52 | 111 | 106 | 163 | 102 |
| DFAS-DE | 82 | 207 | 315 | 74 | 255 | 361 | 615 | 756 | 587 |
| DFAS-IN | 2,232 | 1,599 | 3,523 | 496 | 729 | 513 | 584 | 1,042 | 819 |
| DFAS-CL | 357 | 168 | 737 | 134 | 233 | 531 | 736 | 1,731 | 862 |
| DFAS-CO | 10 | 0 | 18 | 6 | 36 | 26 | 57 | 220 | 105 |
| DFAS-KC | 167 | 29 | 19 | 28 | 26 | 77 | 67 | 106 | 38 |
| Total | 3,224 | 2,226 | 4,786 | 935 | 1,507 | 1,859 | 2,428 | 4,526 | 2,696 |

DFAS

Cross Disbursements

As of September 30, 1997



***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

***FINANCIAL SYSTEMS
ORGANIZATION***

OVERVIEW

Overview

Overview

DEFENSE FINANCE AND ACCOUNTING SERVICE DEFENSE WORKING CAPITAL FUND FINANCIAL SYSTEMS ORGANIZATION OVERVIEW OF THE REPORTING ENTITY

These financial statements report on the financial position and results of operations of the Defense Finance and Accounting Service (DFAS) Information Services business area of the Defense Working Capital Fund (DWCF) for FY 1997. The DFAS Financial Systems Organization (FSO) provides Information Services support to its customers. The statements are prepared pursuant to the requirements of the Chief Financial Officer's Act of 1990 (CFO) and Department of Defense (DoD) implementing guidance.

The financial statements include all aspects of DFAS Information Services operations. They do not include any other appropriated, trust, or revolving funds. The principal statements are prepared from the same sources as are reports used to monitor and control budgetary resources.

Description of the Reporting Entity

The Defense Finance and Accounting Service (DFAS) Financial Systems Organization (FSO) functions as a fee-for-service operation under the DWCF in the Information Services business area. The FSO provides software development/modernization and systems maintenance support to over 100 Automated Information Services (AIS), as well as providing overall technical support in a number of system-related areas. The primary area is the acquisition, deployment, and support for the DFAS information technology (I/T) infrastructure.

The FSO operates as a single organization with a small headquarters contingent located in Indianapolis and subordinate Financial Systems Activities (FSAs) in Cleveland, Columbus, Pensacola, Indianapolis, Kansas City, and Denver. During FY 1997, the FSO delivered over 2.5 million direct labor hours in accomplishing its software development and maintenance mission. This is a 4 percent increase over the total hours delivered during FY 1996.

In addition to providing much of the technical support that resulted in many of the accomplishments noted in the DFAS Financial Operations section of this report, the FSO's major initiatives during FY 1997 included:

- Completion of a Deputy Secretary of Defense directed analysis to study the costs and benefits of developing finance and accounting systems in-house compared with outsourcing those activities and to "benchmark" the FSO's practices and costs against industry standards. The study was performed by Real Decisions, Inc., a Gartner Group Company, the largest independent information technology benchmark consultant. Real Decisions collected

Overview

performance data about the FSO's FY 1996 software and development and maintenance projects, and analyzed and compared this data with the benchmark database of over 15,000 applications and 10,000 development projects. As directed, the final report was provided to the Deputy Secretary of Defense in September 1997. Major findings reported include:

- The FSO provided FY 1996 services for between \$61 million and \$130 million less than its industry and government peers.
- The FSO enjoys one of the lowest per unit costs of any company in the Real Decisions database. In comparing the FSO unit costs to the benchmark database, the analysis indicates that the other government organizations are 80 percent more costly; the average of all companies are 97 percent more costly; and the other peer groups are 141 percent more costly than the FSO.
- The FSO is able to produce functionality at a rate almost double that of most companies and 2.5 times faster than its enhancement and government peer groups.
- The FSO supports a very large portfolio that is 60 percent more complex than the typical software organization with 45 percent better productivity and 10 percent less unit cost while maintaining a high level of customer satisfaction.
- The FSO's customer satisfaction is near the high end of the scale for all companies in the database - with positive perceptions of the FSO as a strategic partner and of the FSO's development efforts.

Specific recommendations by DFAS as a result of this study are:

- The software development functions of the FSO not be outsourced.
- Workyear and end-strength limitation on in-house labor be relaxed or removed in order to avoid long-term dependence on more expensive per hour contractor support.
- Current high productivity levels be maintained through increased investments in training, equipment, and software tools to refresh in-house knowledge about, and apply, new and emerging technologies.

The FSO's Software Process Improvement (SPI) program is a multi-year effort to standardize and improve software development processes and practices. The FSO is utilizing the capability maturity model (CMM) developed by the Software Engineering Institute (SEI) as the basis for its program. An additional seven application systems were evaluated during FY 1997 and subsequently assessed at Level II of the Maturity Model bringing to nine the total number of systems within DFAS which have attained this level. This brings to successful completion the FSO's initial plan to attain an overall CMM Level II status.

Overview

FY 1997 was the second year of the DFAS Federal Information Processing (FIP) contract, which was awarded in 1995. This contract continued to provide DFAS with an effective mechanism to acquire information technology (IT) products and services at significantly reduced costs. The FIP contract continued to provide savings through the use of DFAS-wide licensing of standard software products-savings that could not have been achieved without the economies of scale provided by large purchases. FIP continued to be the major provider of services and equipment for the stand up of the new DFAS operating locations and expansion of existing locations.

During FY 1997 the FSO provided Information Technology (IT) support in assessing and changing many DFAS applications in the area of Year 2000 (Y2K) compliance. The Y2K problem impacts DFAS' Automated Information Systems (AIS) and its AIS hardware. The potential impact to the finance business area included non-payment or erroneous payment to military and civilian employees, retirees, and vendors. The potential impact to the accounting business area includes reports not produced, or worse, erroneous reports. The DFAS overall goal is to provide a DFAS-wide coordinated effort that ensures no system is adversely affected by Y2K problems. This will be accomplished through a DFAS management strategy that calls for centralized policy and decentralized implementation using five phases supported by program and project management activities: awareness, assessment, renovation, validation, and implementation. This goal will allow the DFAS components the flexibility to implement solutions as deemed appropriate while benefiting from best practices in a coordinated effort. DFAS has completed the awareness and assessment phases. Y2K points of contact (POC) have been assigned at multiple levels throughout the organization to coordinate all Y2K efforts. An inventory of the DFAS AIS has been created and all have been analyzed for potential Y2K impact. Of the systems currently being tracked, approximately one-third are being repaired, one-third are scheduled for replacement, and one-third are already compliant or are in development. DFAS is on schedule to meet its goal of having all systems certified as Y2K compliant and implemented not later than December 31, 1998.

During FY 1997, the FSO installed Firewall and Encryption devices on the DFAS Enterprise Local Area Network (ELAN). Installation of these devices created a virtual private network (VPN) for all DFAS ELAN users. This greatly increased the security of the network and significantly lowered the risk of any unauthorized disclosure of DFAS data.

FY 1997 was the first year of the Defense Financial Integrated Systems Services (DFISS) contract. DFISS was competed and awarded in late FY 1996 as a single contract vehicle for the acquisition of contract services in support of DFAS initiatives. The first year proved to be remarkably successful, with virtually all major DFAS software development activities being transitioned to DFISS. By consolidating previously awarded contracts under DFISS, significant cost and administrative savings were achieved. Contracting lead-times were greatly reduced, with the average award requiring less than 30 days from receipt of a requirement to award of a task order, and external contracting fees in the range of 2 to 4 percent of contract awards were eliminated. Significant strides were also made in combining small-scale efforts into larger omnibus contracts, reducing overhead costs and providing improved technical management.

Overview

The FSO successfully implemented the Government wide Purchas Card program. Savings to the FSO resulted from the advantages of “on the spot” purchasing and receiving, reduction in paperwork, and significant reduction in administrative time to support FSO wide micropurchases.

Manpower

DFAS-FSO has taken aggressive measures to respond favorably to the DoD manpower requirement to downsize both the military and civilian workyear levels. For the last four years, DFAS-FSO has exceeded the OUSD(C) mandatory civilian and military reduction goals.

The military and civilian end strength at DFAS-FSO as of September 30, 1996:

| | |
|----------|-------|
| Military | 96 |
| Civilian | 1,323 |

Selected Financial Data:

| | FY96 | FY97 | Net Change |
|----------------------------|---------|---------|------------|
| Revenues (\$M) | \$180.3 | \$204.1 | \$23.8 |
| Expenses (\$M) | | | |
| Direct Billable Labor Hour | 130.9 | 145.1 | 14.2 |
| Support to Others | 51.9 | 56.1 | 4.2 |
| Total | 182.8 | 201.2 | 18.4 |
| Net Operating Result (\$M) | (2.5) | 2.9 | 5.4 |
| Unit Cost per Hour | \$54.46 | \$56.71 | \$2.25 |

The increase in expenses between FY 96 and FY 97 are primarily attributable to a 4 percent increase in accomplished A Goal, Direct Billable Labor Hour workload which required additional, more expensive contractor support; the payment of \$2.3 million for the Marine Corps staff at our Kansas City facility (during FY 96, the Marine Corps did not bill us for this support); and, increased depreciation expenses.

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE

WORKING CAPITAL
FUND

FINANCIAL SYSTEMS
ORGANIZATION

PRINCIPAL STATEMENTS***

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Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund (5F40)
Statement of Financial Position
As of September 30, 1997
(Thousands)

| ASSETS | <u>1997</u> | <u>1996</u> |
|--|--------------------|--------------------|
| 1. Entity Assets: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balance with Treasury (Note 2) | (\$11,832) | (\$34,669) |
| (2) Investments, Net (Note 4) | 0 | 0 |
| (3) Accounts Receivable, Net (Note 5) | 33,764 | 36,320 |
| (4) Interest Receivable | 0 | 0 |
| (5) Advances and Prepayments | 0 | 0 |
| (6) Other Federal (Intragovernmental) (Note 6) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Investments (Note 4) | 0 | 0 |
| (2) Accounts Receivable, Net (Note 5) | 8 | 0 |
| (3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7) | 0 | 0 |
| (4) Interest Receivable, Net | 0 | 0 |
| (5) Advances and Prepayments | (2) | 1 |
| (6) Other Non-Federal (Governmental) (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Inventory, Net (Note 8) | 0 | 0 |
| e. Work in Process (Note 9) | 0 | 0 |
| f. Operating Materials/Supplies, Net (Note 10) | 0 | 0 |
| g. Stockpile Materials, Net (Note 11) | 0 | 0 |
| h. Seized Property (Note 12) | 0 | 0 |
| i. Forfeited Property, Net (Note 13) | 0 | 0 |
| j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14) | 0 | 0 |
| k. Property, Plant and Equipment, Net (Note 15) | 21,735 | 22,478 |
| l. War Reserves | 0 | 0 |
| m. Other Entity Assets | 20,181 | 8,045 |
| n. Total Entity Assets | \$63,854 | \$32,175 |
| 2. Non-Entity Assets: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balance with Treasury (Note 2) | \$0 | \$0 |
| (2) Accounts Receivable, Net (Note 5) | 0 | 0 |
| (3) Interest Receivable, Net | 0 | 0 |
| (4) Other (Note 6) | 0 | 0 |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund (5F40)
 Statement of Financial Position
 As of September 30, 1997
 (Thousands)

| ASSETS, Continued | <u>1997</u> | <u>1996</u> |
|---|------------------------|------------------------|
| 2. Non-Entity Assets: | | |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Receivable, Net (Note 5) | \$0 | \$0 |
| (2) Interest Receivable, Net | 0 | 0 |
| (3) Other (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Other Non-Entity Assets | 0 | 0 |
| e. Total Non-Entity Assets | <u>\$0</u> | <u>\$0</u> |
| 3. Total Assets | <u><u>\$63,854</u></u> | <u><u>\$32,175</u></u> |
| LIABILITIES | | |
| 4. Liabilities Covered by Budgetary Resources: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | \$9,874 | \$15,546 |
| (2) Interest Payable | 0 | 0 |
| (3) Debt (Note 16) | 0 | 0 |
| (4) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 28,393 | 25,649 |
| (2) Accrued Payroll and Benefits | | |
| (a) Salaries and Wages | 653 | 320 |
| (b) Annual Accrued Leave | 0 | 0 |
| (c) Severance Pay and Separation Allowance | 0 | 0 |
| (3) Interest Payable | 0 | 0 |
| (4) Liabilities for Loan Guarantees (Note 7) | 0 | 0 |
| (5) Lease Liabilities (Note 18) | 0 | 0 |
| (6) Pensions and Other Actuarial Liabilities (Note 19) | 0 | 0 |
| (7) Other Non-Federal (Governmental) Liabilities (Note 17) | 0 | 0 |
| c. Total Liabilities Covered by Budgetary Resources: | <u><u>\$38,920</u></u> | <u><u>\$41,515</u></u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund (5F40)
Statement of Financial Position
As of September 30, 1997
(Thousands)

| LIABILITIES, Continued | <u>1997</u> | <u>1996</u> |
|--|------------------------|------------------------|
| 5. Liabilities Not Covered by Budgetary Resources: | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | \$0 | \$0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 0 | 0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Lease Liabilities (Note 18) | 0 | 0 |
| (4) Pensions and Other Actuarial Liabilities (Note 19) | 0 | 0 |
| (5) Other Non-Federal (Governmental) Liabilities (Note 17) | 6,084 | 6,084 |
| c. Total Liabilities Not Covered by Budgetary Resources | <u>\$6,084</u> | <u>\$6,084</u> |
| 6. Total Liabilities | <u>\$45,004</u> | <u>\$47,599</u> |
| NET POSITION (Note 20) | | |
| 7. Balances: | | |
| a. Unexpended Appropriations | \$0 | \$0 |
| b. Invested Capital | 28,908 | (8,162) |
| c. Cumulative Results of Operations | (3,974) | (1,178) |
| d. Other | 0 | 0 |
| e. Future Funding Requirements | (6,084) | (6,084) |
| f. Total Net Position | <u>\$18,850</u> | <u>(\$15,424)</u> |
| 8. Total Liabilities and Net Position | <u><u>\$63,854</u></u> | <u><u>\$32,175</u></u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund (5F40)

Statement of Operations and Changes in Net Position

For the Period Ended September 30, 1997

(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|-----------------------|-------------------------|
| REVENUES AND FINANCING SOURCES | | |
| 1. Appropriated Capital Used | \$0 | \$0 |
| 2. Revenues from Sales of Goods and Services | | |
| a. To the Public | 0 | 0 |
| b. Intragovernmental | 204,138 | 180,271 |
| 3. Interest and Penalties, Non-Federal | 0 | 0 |
| 4. Interest, Federal | 0 | 0 |
| 5. Taxes (Note 21) | 0 | 0 |
| 6. Other Revenues and Financing Sources (Note 22) | 0 | 0 |
| 7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies | 0 | 0 |
| 8. Total Revenues and Financing Sources | <u>\$204,138</u> | <u>\$180,271</u> |
| EXPENSES | | |
| 9. Program or Operating Expenses (Note 23) | \$0 | \$0 |
| 10. Cost of Goods Sold (Note 24) | | |
| a. To the Public | 0 | 0 |
| b. Intragovernmental | 194,005 | 176,503 |
| 11. Depreciation and Amortization | 7,166 | 6,332 |
| 12. Bad Debts and Writeoffs | 0 | 0 |
| 13. Interest | | |
| a. Federal Financing Bank/Treasury Borrowing | 0 | 0 |
| b. Federal Securities | 0 | 0 |
| c. Other | 0 | 0 |
| 14. Other Expenses (Note 25) | 0 | 0 |
| 15. Total Expenses | <u>\$201,171</u> | <u>\$182,835</u> |
| 16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items | \$2,967 | (\$2,564) |
| 17. Plus (Minus) Extraordinary Items (Note 26) | <u>0</u> | <u>0</u> |
| 18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | <u><u>\$2,967</u></u> | <u><u>(\$2,564)</u></u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Defense Finance and Accounting Service - Working Capital Fund (5F40)
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|-----------------|-------------------|
| EXPENSES, Continued | | |
| 19. Net Position, Beginning Balance, as Previously Stated | (\$15,424) | \$22,764 |
| 20. Adjustments (Note 27) | 0 | 0 |
| 21. Net Position, Beginning Balance, as Restated | (\$15,424) | \$22,764 |
| 22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | 2,967 | (2,564) |
| 23. Plus (Minus) Non Operating Changes (Note 28) | 31,307 | (35,624) |
| 24. Net Position, Ending Balance | <u>\$18,850</u> | <u>(\$15,424)</u> |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
 Defense Finance and Accounting Service - Working Capital Fund (5F40)
 Statement of Cash Flows
 For the Period Ended September 30, 1997
 (Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|-------------|-------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| 1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | \$2,967 | (\$2,564) |
| Adjustments Affecting Cash Flow: | | |
| 2. Appropriated Capital Used | 0 | 0 |
| 3. Decrease (Increase) in Accounts Receivable | 2,548 | (9,568) |
| 4. Decrease (Increase) in Other Assets | 2 | 48 |
| 5. Increase (Decrease) in Accounts Payable | (2,929) | 6,275 |
| 6. Increase (Decrease) in Other Liabilities | 333 | (1,273) |
| 7. Depreciation and Amortization | 7,166 | 6,331 |
| 8. Other Unfunded Expenses | 0 | 0 |
| 9. Other Adjustments | (5,763) | 0 |
| 10. Total Adjustments | \$1,357 | \$1,813 |
| 11. Net Cash Provided (Used) by Operating Activities | \$4,324 | (\$751) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| 12. Sale of Property, Plant and Equipment | \$0 | \$0 |
| 13. Purchase of Property, Plant and Equipment | (16,156) | (33,918) |
| 14. Sale of Securities | 0 | 0 |
| 15. Purchase of Securities | 0 | 0 |
| 16. Collection of Loans Receivable | 0 | 0 |
| 17. Creation of Loans Receivable | 0 | 0 |
| 18. Other Investing Cash Provided (Used) | 0 | 0 |
| 19. Net Cash Provided (Used) by Investing Activities | (\$16,156) | (\$33,918) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| 20. Appropriations (Current Warrants) | \$0 | \$0 |
| 21. Add: | | |
| a. Restorations | 0 | 0 |
| b. Transfers of Cash from Others | 0 | 0 |
| 22. Deduct: | | |
| a. Withdrawals | 0 | 0 |
| b. Transfers of Cash to Others | (34,669) | 9,543 |
| 23. Net Appropriations | \$34,669 | (\$9,543) |

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense

Defense Finance and Accounting Service - Working Capital Fund (5F40)

Statement of Cash Flows

For the Period Ended September 30, 1997

(Thousands)

| | <u>1997</u> | <u>1996</u> |
|--|--------------------------|--------------------------|
| CASH FLOWS FROM FINANCING ACTIVITIES, Continued | | |
| 24. Borrowing from the Public | \$0 | \$0 |
| 25. Repayments on Loans to the Public | 0 | 0 |
| 26. Borrowing from the Treasury and the Federal Financing Bank | 0 | 0 |
| 27. Repayments on Loans from the Treasury and the Federal Financing Bank | 0 | 0 |
| 28. Other Borrowings and Repayments | <u>0</u> | <u>0</u> |
| 29. Net Cash Provided (Used) by Financing Activities | <u>\$34,669</u> | <u>(\$9,543)</u> |
| 30. Net Cash Provided (Used) by Operating, Investing and Financing Activities | \$22,837 | (\$44,212) |
| 31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning | <u>(34,669)</u> | <u>9,543</u> |
| 32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending | <u><u>(\$11,832)</u></u> | <u><u>(\$34,669)</u></u> |

Supplemental Disclosure of Cash Flow Information:

| | <u>1997</u> | <u>1996</u> |
|-------------------------|-------------|-------------|
| 33. Total Interest Paid | \$0 | \$0 |

Supplemental Schedule of Financing and Investing Activity:

| | <u>1997</u> | <u>1996</u> |
|--|-------------|-------------|
| 34. Property and Equipment Acquired Under Capital Lease Obligations | \$0 | \$0 |
| 35. Property Acquired Under Long-Term Financing Arrangements | \$0 | \$0 |
| 36. Other Exchanges of Non-cash Assets or Liabilities | \$0 | \$0 |

The accompanying notes are an integral part of these statements.

Principal Statements

The accompanying notes are an integral part of these statements.

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE

WORKING CAPITAL
FUND

FINANCIAL SYSTEMS
ORGANIZATION

FOOTNOTES
TO THE
PRINCIPAL STATEMENTS***

Footnotes

**DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
DEFENSE WORKING CAPITAL FUND
FINANCIAL SYSTEMS ORGANIZATION
NOTES TO THE PRINCIPAL STATEMENTS
AS OF SEPTEMBER 30, 1997**

Note 1. Significant Accounting Policies

A. Basis of Presentation:

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the Department in accordance with DoD Guidance on Form and Content of Financial Statements For FY 1995/1996 Financial Activity (as adopted from FMR, Volume 6, Chapter 6 issued January 1998, "Form and Content of Audited Financial Statements") and DoD's accounting policies which are summarized in this note. These statements, therefore, are different from the financial reports, also prepared by the DoD pursuant to OMB directive, that are used to monitor and control DoD's use of budgetary resources.

B. Reporting Entity:

The Defense Finance and Accounting Service (DFAS) Financial Systems Organization (FSO) functions as a fee-for-service operation under the Defense Working Capital Fund (DWCF) in the Information Services business area. The FSO provides software development/modernization and systems maintenance support to over 100 Automated Information Systems (AIS), as well as providing overall technical support in a number of system-related areas. The primary area is the acquisition, deployment, and support for the DFAS information technology (I/T) infrastructure.

The FSO operates as a single organization with a small headquarters contingent located in Indianapolis and subordinate Financial Systems Activities (FSAs) in Cleveland, Columbus, Pensacola, Indianapolis, Kansas City, and Denver. During fiscal year (FY) 1996, the FSO delivered over 2.4 million direct labor hours in its' mission of supporting many of the finance and accounting initiatives discussed in the previous pages of this report.

The Defense Business Management System (DBMS), an automated management information system, is used by the Agency to develop the financial and other managerial information. DBMS was designated as the migratory system for the Defense Working Capital Fund.

C. Budgets and Budgetary Accounting:

The Department expanded the use of professional financial management practices through the establishment of the Defense Working Capital Fund (formerly the Defense Business Operations Fund) on October 1, 1991. The Fund operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision-making process. The Fund builds on the revolving fund principles previously used for industrial and commercial-type activities.

The DFAS Financial Services Organization's (FSO) major budget activity is the financial operations business area operating under the Working Capital Fund (Account Symbol 97X4930.5F40), a revolving fund.

D. Basis of Accounting:

Transactions are recorded on a accrual accounting basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Also, when costs are incurred on a relatively uniform basis over the life of an order, revenue may be recognized as a percentage of incurred costs to total projected costs. At a minimum, the customer shall be billed and revenue recognized at the end of each fiscal year quarter. In summary the Fund shall operate under financial policies and responsibilities currently in effect for stock and industrial funds, except as modified by DoD Comptroller policy documents.

E. Revenues and Other Financing Sources:

Revenue is earned and recognized when services are completed and billed or on a percentage of completion method.

For financial reporting purposes under accrual accounting, operating expenses are recognized in the period incurred. Expenditures for capital and other long-term assets are receipted then capitalized when purchased, but are not depreciated until they are put into operation by the Department.

Prior to FY96, due to inadequate system support, the annual leave liability was treated as an unfunded liability and future funding requirements on the Statement of Financial Position. In FY96, it was determined that any increase to the annual leave account (GLAC 2300.000) between the FY95 and FY96 ending balances would be recorded on the Statement of Operations and Changes in Net Position as an expense and as a funded liability on the Statement of Financial Position. If the change in the FY97 and FY96 ending balances results in a decrease, the unfunded liability and future funding requirement on the Statement of Financial Position would be adjusted accordingly.

F. Accounting for Intra-governmental Activities:

The FSO, as DFAS's systems development provider, interacts with the other DoD Components in a typical business manner i.e. provides systems accounting service to the Program Managers and DoD Comptroller. Our service includes the accounting and finance service for approximately 300 fund accounts. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department or the Business Operations Fund. These statements reflect the Financial Operations and Financial Systems Organization business portion of the Working Capital Fund.

Like the other DoD Components, the DFAS employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while assigned military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security.

G. Funds with the U.S. Treasury and Cash:

The Agency's fund resources as part of the Working Capital Fund are maintained in the Treasury account. The Fund's cash receipts and disbursements are processed by the Treasury, and the balance with the Treasury represents the aggregate of all unexpended balances at the summary level.

H. Foreign Currency:

Not Applicable.

I. Accounts Receivable:

As presented in the Statement of Financial Position, accounts receivable includes accounts, claims, and refunds receivable and advance payments to other entities

J. Loans Receivable:

Not Applicable.

K. Inventories:

Not Applicable.

L. Investments in U.S. Government Securities:

Not Applicable.

M. Property and Equipment:

Footnotes

All Defense Finance and Accounting Service property, plant and equipment is recorded in the Defense Property Accountability System (DPAS). The capital assets include, but are not limited to, physical plant and property, (including government owned facilities, property acquired under a capital lease or an operating lease), equipment and software. The assets were purchased with capital funds. For assets purchased with Fiscal Year 1992 and 1993 capital funds, the original purchase price (including installation and transportation costs) exceeded \$15,000. For assets purchased with Fiscal Year 1994 capital funds, the original purchase price exceeded \$25,000. For assets purchased with Fiscal Year 1995 and Fiscal Year 1996 capital funds, the original purchase price exceeded \$50,000.

DPAS was balanced and reconciled to the certified trial balances for fiscal year 1997. The largest component of property, plant, and equipment is Equipment with a Net Book Value of \$20,577. The Net Book Value for Fixed Assets (In-Use) is \$21,735.

Routine maintenance and repair costs are expensed when incurred. Depreciation of property and equipment is calculated on a straight line basis. Defense Finance and Accounting Service (DFAS) expensed \$7,166 in depreciation for this fiscal year and expensed 17,513 in depreciation from inception of the Defense Business Operations Fund. The accumulated depreciation which includes depreciation on assets transferred-in, from inception \$16,984 (See Note 15 for the Book Value of DFAS's depreciated assets).

The General Accounting Office (GAO) has determined that real property used by the DWCF, but under the jurisdiction of the Military Departments, represents an asset of the DWCF and such property should be reported on the financial statements as an entity asset to show the full costs of all resources and assets used in DWCF operations.

N. Prepaid and Deferred Charges:

Not Applicable.

O. Leases:

Not Applicable.

P. Contingencies:

Not Applicable.

Q. Accrued Leave:

Civilian employee annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for the civilian annual leave and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of nonvested leave are expensed as taken. Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued

annual leave account is adjusted to reflect current pay rates. To the extent current of prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. DFAS has \$6,084 in Accrued Annual Leave that is reported as a liability not covered by current budgetary resources.

R. Equity:

Equity consists of invested capital, cumulative result of operations, and future funding requirements. Invested capital, as presented in the Statement of Financial Position, represents the net value of the capital asset transferred to or from the DFAS-Financial Operations and Financial Systems organization from or to other organizations. Invested capital also includes the reduction of the Real Property Maintenance Reserve Account.

Cumulative Results of Operations represents the excess of revenues over total expenses since the inception of the reporting entity, less refunds to customers and returns to the U. S. Treasury.

S. Aircraft/Ship Crashes:

Not Applicable.

T. Treaties for Use of Foreign Bases:

Not Applicable.

U. Comparative Data [for use by reporting entities preparing CFO financial statements for the first time]:

Not Applicable.

Footnotes

W. Undelivered Orders:

All DoD Components are obligated for goods and services which have been ordered but not yet received (undelivered orders) as of September 30, 1997. Aggregate undelivered orders amounted to \$32,442 as of September 30, 1997.

Note 2. Fund Balances with Treasury

A. Working Capital Fund (USD(C)) and All Other Funds and Accounts:

Not Applicable.

B. Working Capital Fund Activities Below (USD(C)) Level:

| | Entity Assets | |
|-------------------------------|------------------------|------------------------|
| | <u>Funds Collected</u> | <u>Funds Disbursed</u> |
| Beginning Balance | 170,737 | (205,406) |
| Transfers of Cash to Others | (170,737) | |
| Transfers of Cash from Others | | 205,406 |
| Funds Collected | 206,683 | |
| Funds Disbursed | | (218,515) |
| Ending Balance | <u>206,683</u> | <u>(218,515)</u> |

C. All Funds and Accounts:

Not Applicable.

D. Other Information:

Cash collections and disbursements data for the financial statements is obtained from the finance network/Cash Outlay System Report and Service listings. The difference between cash collections in the finance network/Cash Outlay System Report and the general ledger amounted to \$241. This amount is reported as an increase in accounts receivable. The difference between cash disbursements in the finance network/Cash Outlay System Report and the general ledger amounted to \$5,287. This amount is reported as an decrease to accounts payable.

Note 3. Cash, Foreign Currency and Other Monetary Assets

Not Applicable.

Note 4. Investments

Not Applicable

Note 5. Accounts Receivable, Net

| | (1) Allowance Amount <u>Due</u> | (2) Allowance For Estimated <u>Uncollectibles</u> | (3) Method <u>Used</u> | (4) Amount <u>Due</u> |
|-----------------------------------|--|--|------------------------------|-----------------------------|
| A. Entity Receivables: | | | | |
| Intragovernmental | 33,762 | | | 33,762 |
| Governmental | 8 | | | 8 |
| Total | 33,770 | | | 33,770 |
| B. Non-Entity Receivables: | | | | |
| Intragovernmental | | | | |
| Governmental | | | | |

C. Other Information:

The Accounts Receivable Intragovernmental was increased by \$206 due to cumulative undistributed collections. Undistributed dollars are the difference between cash collections in the finance network/Cash Outlay System Report and the general ledger.

Accounts receivable may also include numerous over-aged and negative transactions. These transactions are currently under investigation for system and processing deficiencies.

Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets

Not Applicable.

Note 7. Loans and Loan Guarantees, Non-Federal Borrowers

Not Applicable.

Note 8. Inventory, Net

Not Applicable.

Note 9. Work in Process

Not Applicable.

Note 10. Operating Materials and Supplies (OM&S), Net

Not Applicable.

Footnotes

Note 11. Stockpile Materials Net

Not Applicable.

Note 12. Seized Property

Not Applicable.

Note 13. Forfeited Property, Net

Not Applicable.

Note 14. Goods Held Under Price Support and Stabilization Programs, Net

Not Applicable.

Note 15. Property, Plant, and Equipment, Net

| | (1) <u>Depreci- ation Method</u> | (2) <u>Service Life</u> | (3) <u>Acquisition Value</u> | (4) <u>Accumulated Depreciation</u> | (5) <u>Net Book Value</u> |
|--|---|--------------------------------|-------------------------------------|--|--------------------------------------|
| <u>Classes of Fixed Assets</u> | | | | | |
| A. Land | | | | | |
| B. Structures, Facilities, & Leasehold Improvements | | | | | |
| C. Military Equipment | | | | | |
| D. ADP Software | SL | 1-5 | 1,567 | 591 | 976 |
| E. Equipment | SL | 6-10 | 36,969 | 16,392 | 20,577 |
| F. Assets Under Capital Lease | | | | | |
| G. Other | | | | | |
| H. Natural Resources | | | | | |
| I. Construction-in-Progress | | | 182 | | 182 |
| Total | | | 38,718 | 16,983 | 21,735 |

*Keys:

| <u>Depreciation Methods</u> | <u>Range of Service Life</u> | |
|--|------------------------------|----------------|
| SL - Straight Line | 1-5 | 1 to 5 years |
| DD - Double-Declining Balance | 6-10 | 6 to 10 years |
| SY - Sum of the Years' Digits | 11-20 | 11 to 20 years |
| IN - Interest (sinking fund) | >20 | Over 20 years |
| PR - Production (activity or use method) | | |
| OT - Other (describe) | | |

Note 16. Debt

Not Applicable.

Note 17. Other Liabilities**A. Other Liabilities Covered by Budgetary Resources:**

Not Applicable.

B. Other Information:

Not Applicable.

C. Other Liabilities Not Covered by Budgetary Resources:

| | Non-Current <u>Liability</u> | Current <u>Liability</u> | <u>Total</u> |
|--------------------------|---------------------------------|-----------------------------|--------------|
| 1. Intragovernmental | | | |
| (1) Accrued Annual Leave | 6,084 | | 6,084 |
| Total | <u>6,084</u> | | <u>6,084</u> |

Note 18. Leases

Not Applicable.

Note 19. Pensions and Other Actuarial Liabilities

Not Applicable.

Footnotes

Note 20. Net Position

| | <u>Revolving Funds</u> | <u>Trust Funds</u> | <u>Appropriated Funds</u> | <u>Total</u> |
|--|----------------------------|------------------------|-------------------------------|---------------|
| A. Unexpended Appropriations: | | | | |
| (1) Unobligated, | | | | |
| a. Available | | | | |
| b. Unavailable | | | | |
| (2) Undelivered Orders | | | | |
| B. Invested Capital | 28,908 | | | 28,908 |
| C. Cumulative Results of Operations | (3,974) | | | (3,974) |
| D. Other | | | | |
| E. Future Funding Requirements | (6,084) | | | (6,084) |
| F. Total | <u>18,850</u> | <u></u> | <u></u> | <u>18,850</u> |

Note 21. Taxes

Not Applicable.

Note 22. Other Revenues and Financing Sources

Not Applicable.

Note 23. Program or Operating Expenses

Not Applicable.

Note 24. Cost of Goods Sold Do A, B, or C as appropriate.

| | |
|--|----------------|
| A. Cost of Services Sold: | |
| (1) Beginning Work-in-Process | 0 |
| (2) Plus: Operating Expenses | |
| (a) Personnel Services and Benefits | 85,975 |
| (b) Travel and Transportation | 3,213 |
| (c) Rental, Communication and Utilities | 5,456 |
| (d) Printing and Reproduction | 528 |
| (e) Contractual Services | 92,799 |
| (f) Supplies and Materials | 2,346 |
| (g) Equipment not Capitalized | 3,603 |
| (h) Grants, Subsidies and Contributions | 75 |
| (i) Other Interests Expense | 10 |
| (3) Minus: Ending Work-in-Process | |
| (4) Minus: Completed Work for Activity Retention | |
| Cost of Services Sold | <u>194,005</u> |

Note 25. Other Expenses

| | <u>1996/7</u> | <u>1995/6</u> |
|---------------------------|---------------|---------------|
| A. Other Expenses: | | |
| (1) Accrued Annual Leave | | 5,884 |
| Total | | <u>5,884</u> |

Note 26. Extraordinary Items

Not Applicable.

Note 27. Prior Period Adjustments

Not Applicable.

Note 28. Non-Operating Changes - (Transfers and Donations)

| | <u>1996/7</u> | <u>1995/6</u> |
|--|-----------------|-----------------|
| A. Increases: | | |
| (1) Transfers-In: | | |
| (a) Prior Year Cash Balance | (34,699) | 9,543 |
| (b) Capital Assets 9/30/97 | 27,060 | (38,946) |
| (2) Unexpended Appropriations | | |
| (3) Donations Received | | |
| (4) Other Increases | | |
| (5) Total Increases | <u>(7,639)</u> | <u>(29,403)</u> |
| | <u>1996/7</u> | <u>1995/6</u> |
| B. Decreases: | | |
| (1) Transfers-Out: | | |
| (a) Capital Assets 9/30/96 | (38,946) | 6,221 |
| (b) | | |
| (c) | | |
| (2) Donations | | |
| (3) Other Decreases | | |
| (4) Total Decreases | <u>(38,946)</u> | <u>6,221</u> |
| C. Net Non-Operating Changes (Transfers): | <u>31,307</u> | <u>(35,624)</u> |

Footnotes

Note 29. Intrafund Eliminations

Schedule B: Eliminating Entries

| Selling Activity: | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|--|----------------------------|-----------------|-------------------------|--------------------|
| | <u>Accounts Receivable</u> | <u>Revenue</u> | <u>Unearned Revenue</u> | <u>Collections</u> |
| Defense Finance and Accounting Service | 31,417 | 190,928 | 0.00 | 194,510 |
| TOTAL | 31,417 | 190,928 | 0.00 | 194,510 |

| Customer Activity: | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|---------------------------|-------------------------|-----------------|-----------------|----------------------|
| | <u>Accounts Payable</u> | <u>Expenses</u> | <u>Advances</u> | <u>Disbursements</u> |
| (SRC/CD) | | | | |
| 417 FSO to DFAS | 31,417 | 190,928 | 0.00 | 194,510 |
| TOTAL | 31,417 | 190,928 | 0.00 | 194,510 |

Schedule C: Eliminating Entries

| Selling Activity: | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|--|----------------------------|-----------------|-------------------------|--------------------|
| | <u>Accounts Receivable</u> | <u>Revenue</u> | <u>Unearned Revenue</u> | <u>Collections</u> |
| Defense Finance and Accounting Service | 2,105 | 13,209 | 0.00 | 12,416 |
| TOTAL | 2,105 | 13,209 | 0.00 | 12,416 |

| Customer Activity: | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|---------------------------|-------------------------|-----------------|-----------------|----------------------|
| | <u>Accounts Payable</u> | <u>Expenses</u> | <u>Advances</u> | <u>Disbursements</u> |
| (SRC/CD) | | | | |
| 411 Navy, Marine Corps | 1,563 | 9,533 | 0.00 | 9,663 |
| 412 Army | 542 | 3,676 | 0.00 | 3,619 |
| TOTAL | 2,105 | 13,209 | 0.00 | 12,416 |

Schedule D: Eliminating Entries

| Selling Activity: | <u>Column A</u> Accounts Receivable | <u>Column B</u> Revenue | <u>Column C</u> Unearned Revenue | <u>Column D</u> Collections |
|---|---|-----------------------------|--|----------------------------------|
| Defense Finance and Accounting Service | 242 | 0.00 | 0.00 | (242) |
| TOTAL | 242 | 0.00 | 0.00 | (242) |
| Customer Activity: | <u>Column A</u> Accounts Payable | <u>Column B</u> Expenses | <u>Column C</u> Advances | <u>Column D</u> Disbursements |
| (SRC/CD) | | | | |
| 300.00 Off Budget Federal Entities | 0.00 | 0.00 | 0.00 | 0.00 |
| 600.00 Foreign Military Sales | 0.00 | 0.00 | 0.00 | 0.00 |
| 822.00 All Others | 0.00 | 0.00 | 0.00 | 0.00 |
| Other (Undistributed) | 242 | N/A | N/A | (242) |
| TOTAL | 242 | 0.00 | 0.00 | (242) |

Note: Earnings were given at a detail level, thus, allowing DFAS-CO to show Expenses at the lowest Customer Activity Level as shown above. However, Accounts Receivable and Collections are not reflected in the Trial Balance using the same detail level source code, therefore, detail Accounts Payable and Disbursements were computed using a percentage of earnings in order to be shown at the same Customer Activity level.

Footnotes

Note 30. Contingencies:

Not Applicable.

Note 31. Other Disclosures:

A. Annual Leave

Prior to FY96, due to inadequate system support, the annual leave liability was treated as an unfunded liability and future funding requirements on the Statement of Financial Position. In FY96, it was determined that any increase to the annual leave account (GLAC 2300.000) between the FY95 and FY96 ending balances would be recorded on the Statement of Operations and Changes in Net Position as an expense and as a funded liability on the Statement of Financial Position. If the change in the FY97 and FY96 ending balances results in a decrease, the unfunded liability and future funding requirement on the Statement of Financial Position would be adjusted accordingly.

B. Unmatched Disbursements (UMDs), Negative Unliquidated Obligations (NULOs), and Aged in-Transit Disbursements:

| Treasury Index 97 DFAS | September 1996 | September 1997 | Change | Percent Change |
|--------------------------------------|-------------------|-------------------|--------|----------------------|
| Unmatched Disbursements | 15,007 | 13,794 | 1,213 | 8.08% (Decrease) |
| Negative Unliquidated Obligations | 1,608 | 585 | 1,023 | 63.19% (Decrease) |
| Totals | 16,615 | 14,379 | 2,236 | 13.46% (Decrease) |

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

***FINANCIAL SYSTEMS
ORGANIZATION***

***SUPPLEMENTAL FINANCIAL
AND MANAGEMENT
INFORMATION***

Program Performance Measures

Financial Attributes

Operating Costs Attributes
(In Millions of Dollars)

| | FY 1997 | FY 1996 |
|-----------------------------|----------------|----------------|
| Total Costs and Expenses | \$204.1 | \$182.8 |
| Revenues and Reimbursements | 201.2 | 180.3 |
| Net Operating Costs | 2.9 | (\$2.5) |
| Percentage of Revenue | 1.4% | (1.4%) |
| Percentage of Change | 116% | |

Operating Results Attribute
(In Millions of Dollars)

| | FY 1997 | FY 1996 |
|--------------------------------|----------------|----------------|
| Revenues | | |
| Federal Sources | \$204.1 | \$182.8 |
| Public Sources | | |
| Other | 0 | 0 |
| Total Revenue | \$204.1 | \$180.3 |
| Expenses and Losses | 201.2 | 182.8 |
| Net Operating Income (Deficit) | \$2.9 | (\$2.5) |
| Additional Appropriations | 0 | 0 |
| Operating Surplus (Deficit) | \$2.9 | (\$2.5) |

**Financial Condition Attribute
(In Thousands of Dollars)**

| | FY 1996 | FY 1995 |
|------------------------------|-------------------|-------------------|
| Available Sources of Cash | \$63,854.0 | \$32,175.0 |
| Future Requirements for Cash | \$45,003.0 | \$47,599.0 |
| Cash Surplus (Shortfall) | | |
| Total Assets * | \$63,851.0 | \$32,175.0 |
| Total Liabilities | <u>\$45,003.0</u> | <u>\$47,599.0</u> |
| Asset to Debt Ratio | 1: .70 | 1: 1.47 |

* Current DoD Policy required the FSO to transfer the FY 1995 ending cash balance of \$9.5M to the cash account maintained for the all Defense Agencies. This requirement distorts the Statement of Cash Flows and the Cash and Equity accounts on the Balance Sheet. The cash account maintained for DFAS by the Defense Logistics Agency at the end of FY 1996 had a negative funds balance of \$25.2M.

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE

WORKING CAPITAL
FUND

AUDIT OPINION***



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

February 27, 1998

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND
CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Disclaimer of Opinion on the Defense Finance and Accounting Service Working
Capital Fund Financial Statements for FY 1997 (Project No. 7FH 2038)**

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and auditors for financial statements, internal controls, and compliance with laws and regulations. Management is responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to DoD financial accounting and reporting. Our responsibility is to render an opinion on the financial statements, and to determine whether internal controls are adequate and whether the entity complied with laws and regulations.

Before FY 1992, the DoD operated a significant number of commercial and industrial facilities under a revolving fund concept. In FY 1992, the revolving funds were consolidated to form the Defense Business Operations Fund (DBOF). The Inspector General, DoD, was responsible for auditing and rendering an opinion on the DBOF consolidated financial statements. In December 1996, the Under Secretary of Defense (Comptroller) restructured the DBOF into separate working capital funds. The Inspector General, DoD, is responsible for auditing and rendering an opinion on the financial statements, for FY 1997 and subsequent years, of the working capital fund reporting entities formerly reported under the DBOF.

Disclaimer of Opinion. We were unable to render an opinion as to whether the DFAS Working Capital Fund Financial Statements for FYs 1997 and 1996 presented fairly, in all material respects, the financial position and results of operations of the DFAS Working Capital Fund in accordance with generally accepted Government accounting principles.

Because of deficiencies in accounting systems, the DFAS Working Capital Fund had substantial undistributed collections and disbursements, and we could not verify balances for expenses. The undistributed amounts materially affected the reported balances for Fund Balance With Treasury (7 percent of total assets), Accounts Receivable (4 percent of total assets), and Accounts Payable (88 percent of total liabilities). As a result, significant portions of the balances were unverifiable. We could not verify balances for expenses because accounting transactions that had been disbursed and finalized were purged on a quarterly basis. After these transactions were purged from the general ledger accounting system (the Defense Business Management System), they could not be restored.

Deficiencies in accounting systems and control procedures resulted in misreported Property, Plant, and Equipment (81 percent of total assets). Balances reported for Property, Plant, and Equipment did not match either the general ledger trial balances produced by the Defense Business Management System, or the subsidiary ledger trial balances produced by the

Defense Property Accountability System. Deficiencies in accounting systems and control procedures also resulted in unrecorded adjustments to the financial statements, which prevented the verification of reported balances.

Accounting Principles. The DFAS Working Capital Fund Financial Statements for FY 1997 were to be prepared in accordance with Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as supplemented by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. These bulletins incorporate the Statements of Federal Financial Accounting Concepts and Standards recommended by the Federal Accounting Standards Advisory Board, which are approved by the Secretary of the Treasury; the Director, OMB; and the Comptroller General of the United States. Footnote 1 of the DFAS Working Capital Fund Financial Statements for FY 1997 discusses the significant accounting policies that DFAS stated it followed in preparing the financial statements.

Internal Controls. We reviewed aspects of the internal control structure of the DFAS Working Capital Fund and obtained an understanding of the internal control policies and procedures. The internal control structure consists of the overall control environment, accounting systems, and control procedures that provide reasonable assurance that accounting data are accumulated, recorded, and reported properly by management and that assets are safeguarded. In addition, we performed a limited review of the implementation of the management control program by the Fund's managers. We performed applicable tests of the internal control structure to determine whether the controls were effective and working as designed.

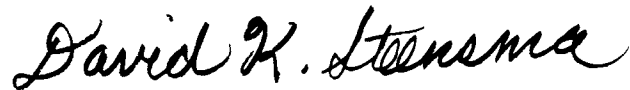
The internal control structure needed improvements in accounting for and managing resources, ensuring compliance with laws and regulations, and ensuring that the financial statements are free of material misstatements. Specifically, management needs to strengthen internal controls over the accounting for Fund Balance With Treasury; Accounts Receivable; Accounts Payable; Property, Plant, and Equipment; Revenues; and over the preparation of the financial statements.

The FY 1997 Annual Statement of Assurance for DFAS identified as repeat material weaknesses within DoD many of the reportable conditions we found in the DFAS Working Capital Fund, such as inadequate financial accounting processes and deficiencies in systems. The Annual Statement of Assurance reported as a new material weakness that work performed by the DFAS Working Capital Fund (specifically, the Financial Systems Organization) was not always funded. Further, in FYs 1997 and 1996, the Accounting Directorate, DFAS Columbus Center, reported a material weakness in accounting for the Fund's undistributed collections and disbursements for Fund Balance With Treasury. However, the weakness was not included in the DFAS Columbus Center's Annual Statement of Assurance for FYs 1997 or 1996.

Compliance With Laws and Regulations. We assessed compliance with laws and regulations related to the financial statements. Noncompliance with laws and regulations is a reportable condition if the noncompliance could result in material misstatements in the financial statements, or if the sensitivity of the matter would cause anyone to perceive the noncompliance as significant.

Management needed to improve compliance with laws and regulations for the preparation and review of accounting reports, disclosure in financial statements, and accounting for revenue and the unbillable costs of services performed for other DoD agencies without customer orders. Also, under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 93-06, Addendum 1, "Audit Requirements for Federal Financial Statements," January 16, 1998, our work disclosed that financial management systems did not

comply with Federal financial management system requirements; applicable Federal accounting standards; and the United States Government Standard General Ledger at the transaction level. Further, the Defense Business Management System did not comply with key accounting requirements of DoD 7000.14-R, the "DoD Financial Management Regulation," for general ledger control, financial reporting, and audit trails.

A handwritten signature in black ink, reading "David K. Steensma". The signature is written in a cursive, flowing style.

David K. Steensma
Deputy Assistant Inspector General
for Auditing

